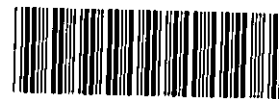


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07021693

# 82- SUBMISSIONS FACING SHEET

MICROFICHE CONTROL LABEL

REGISTRANT'S NAME

QBE Insurance Group Limited

\*CURRENT ADDRESS

82 Pitt Street  
Sydney NSW 2000  
Australia

\*\*FORMER NAME

\*\*NEW ADDRESS

PROCESSED

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FINANCIAL

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FISCAL YEAR 12/31/08

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DATE: 3/9/07

QBE

Insurance  
Group

February 23, 2007

Securities and Exchange Commission  
Division of Corporation Finance  
Office of International Corporate Finance  
100 F Street, N.E.  
WASHINGTON, D.C. 20549  
U S A

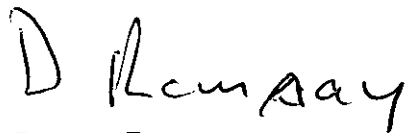
**BY COURIER**

Dear Ladies and Gentlemen:

re: **Rule 12g3-2(b) Application for QBE Insurance Group Limited**

Further to my letter of February 16, 2007, please find enclosed our 2006 annual report as an addition to Schedule B since my letter was sent.

Yours faithfully,



Duncan Ramsay  
**General Counsel and Company Secretary**

Annual report enclosed

RECEIVED  
2007 FEB 27 A 11:23  
OFFICE OF INTERNATIONAL  
CORPORATE FINANCE

QBE INSURANCE GROUP LIMITED  
ABN 28 008 485 014

Head Office  
82 Pitt Street  
Sydney NSW 2000  
AUSTRALIA

**Postal Address**  
GPO Box 82  
Sydney NSW 2001  
AUSTRALIA

Telephone: +61 (2) 9375 4444  
Facsimile: +61 (2) 9235 3166  
DX 10171 Sydney Stock Exchange



**QBE INSURANCE GROUP**  
**ANNUAL REPORT DECEMBER 2006**

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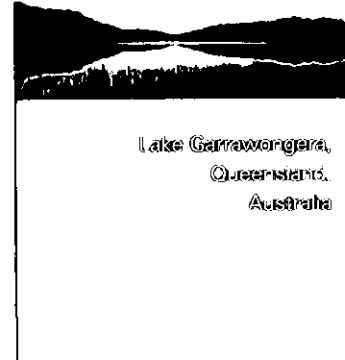
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2006 in review	1	European operations	38
Chairman's report	2	the Americas	42
Historical review	6	Investments	44
Chief executive officer's report	8	Board of directors	46
Worldwide portfolio mix	14	Corporate governance statement	52
Group financial targets and performance goals	16	Directors' report	69
Risk management	18	Annual financial report	138
QBE people	20	Directors' declaration	139
Group operations executive	22	Independent audit report	140
Operations overview	24	Shareholder information	144
Australia Pacific Asia Central Europe	26	Financial calendar and ASX announcements	



## NET PROFIT AFTER INCOME TAX

# \$1,483M

Up **36%** from last year

## RETURN ON EQUITY

# 26.1%

Up from **23.9%** last year

## GROSS WRITTEN PREMIUM

# \$10,372M

Up **10%** from last year

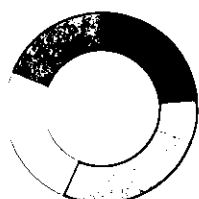
## NET EARNED PREMIUM

# \$8,158M

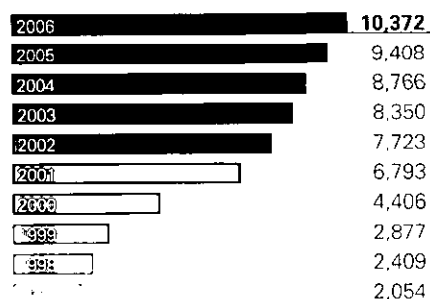
Up **10%** from last year

## GROSS EARNED PREMIUM \$M

- Australia \$2,428
- Pacific Asia Central Europe \$704
- QBE Insurance (Europe) \$2,586
- Lloyd's division \$2,475
- the Americas \$1,876



## GROSS WRITTEN PREMIUM \$M



Compound annual growth  
of **21%** over the last 10 years

# in review

PROFIT AND DIVIDEND PAYOUT		2006	2005	% CHANGE
Net profit after income tax	\$M	1,483	1,091	36
Profit before income tax	\$M	2,012	1,523	32
Basic earnings per share <sup>(1)</sup>	cents	184.8	142.5	30
Diluted earnings per share <sup>(2)</sup>	cents	173.5	131.5	32
Dividend per share	cents	95.0	71.0	34
Shareholders' funds	\$M	6,283	5,093	23

GROUP OPERATING PERFORMANCE		2006	2005	% CHANGE
Gross written premium	\$M	10,372	9,408	10
Gross earned premium	\$M	10,069	9,171	10
Net earned premium	\$M	8,158	7,386	10
Combined operating ratio	%	85.3	89.1	
Insurance profit	\$M	1,788	1,288	39
Insurance profit to net earned premium	%	21.9	17.4	
Cash flow from operations	\$M	2,039	1,987	3

CONTRIBUTIONS BY REGION			2006	2005	% CHANGE
Australia	Gross earned premium	\$M	2,428	2,405	1
	Combined operating ratio	%	82.9	83.6	
Pacific Asia Central Europe	Gross earned premium	\$M	704	688	2
	Combined operating ratio	%	84.4	82.3	
QBE Insurance (Europe)	Gross earned premium	\$M	2,586	2,370	9
	Combined operating ratio	%	88.8	90.0	
Lloyd's division	Gross earned premium	\$M	2,475	2,273	9
	Combined operating ratio	%	82.1	94.5	
the Americas	Gross earned premium	\$M	1,876	1,435	31
	Combined operating ratio	%	89.7	92.9	
Equator Re <sup>(3)</sup>	Gross earned premium	\$M	678	347	95
	Combined operating ratio	%	81.4	89.8	
Investment income	Gross	\$M	985	843	17
	Net of finance costs and investment expenses	\$M	822	718	14

ALL AMOUNTS IN THIS REPORT ARE DENOMINATED IN AUSTRALIAN DOLLARS UNLESS OTHERWISE SPECIFIED

(1) Reflects shares notified to the Australian Stock Exchange. Refer to note 25(A) to the financial statements.

(2) Assumes that all hybrid securities are fully dilutive

(3) Equator Re is the Group's captive reinsurance company based in Bermuda



# Chairman's report

Your board is pleased to report that QBE has again produced an outstanding result for shareholders in 2006 with net profit after tax up 36% to \$1,483 million and a superb technical underwriting result and record insurance profit.

Management's focus on profitability, together with favourable insurance market conditions, continuing stable world economic conditions and strengthening investment markets, supported the excellent technical and financial result.

The record profit performance has delivered a significant return on average shareholders' funds of 26.1% compared with 23.9% in 2005, and an increase of 32% in diluted earnings per share.

In recognition of the substantial increase in profit and as a sign of our confidence in future earnings, the directors have declared a final dividend of 55 cents per share, up 45% on the final dividend of 38 cents per share for 2005. The final dividend will be 60% franked, and the dividend reinvestment and dividend election plans which were suspended in August 2006 have been reinstated.

QBE's excellent share price performance reflects the strong profit and positive reaction to recently announced acquisitions in the US. QBE shares outperformed the Australian All Ordinaries Accumulation Index and inflation with a growth rate of 52% in 2006 and a compound annual average growth rate of 35% over the past five years and 23% over the last ten years. QBE's market capitalisation in the past 12 months increased by 52% to \$24 billion at 31 December 2006.

The increased profit, the dividend reinvestment plans and the conversion of hybrid securities during the year resulted in shareholders' funds increasing by 23% to \$6,283 million. The number of issued shares notified to the Australian Stock Exchange increased by 25 million in the year to 819 million.

## SHAREHOLDERS' HIGHLIGHTS

FOR THE YEAR ENDED 31 DECEMBER		2006	2005
Net profit after income tax	\$M	1,483	1,091
Basic earnings per share <sup>(1)</sup>	cents	184.8	142.5
Diluted earnings per share <sup>(2)</sup>	cents	173.5	131.5
Dividend payout	\$M	774	556
Dividend per share <sup>(1)</sup>	cents	95.0	71.0
Net tangible assets per share <sup>(1)</sup>	\$	5.95	4.76
Cash flows from operations	\$M	2,039	1,987
Total investments and cash <sup>(3,4)</sup>	\$M	19,972	17,597
Total assets	\$M	31,757	29,665
Return on average shareholders' funds <sup>(5)</sup>	%	26.1	23.9
Shareholders' funds	\$M	6,283	5,093
Borrowings to shareholders' funds <sup>(6)</sup>	%	37.6	41.8
Capital adequacy multiple		2.4	1.9

(1) Reflects shares notified to the Australian Stock Exchange.  
Refer to note 25(A) to the financial statements.

(2) Assumes that all hybrid securities are fully dilutive

(3) Excludes ABC financial assets pledged for funds at Lloyd's.

(4) Includes financial assets, cash and investment properties.

(5) Includes the equity portion of hybrid securities issued in 2002 and 2004

(6) Excludes ABC securities for funds at Lloyd's

The financial statements have been prepared in accordance with the Australian equivalents to International Financial Reporting Standards ("AIFRS"). QBE adopted AIFRS in 2005.

The balance sheet and all key ratios strengthened during 2006. Based on the estimated capital requirement for Australian regulated insurance companies, the capital adequacy multiple at 31 December 2006 was 2.4 times the minimum requirement. We have made a number of assumptions in applying the Australian Prudential Regulation Authority's ("APRA") risk-based capital approach for Australian insurers, noting that APRA has not yet finalised prudential standards for calculating consolidated capital adequacy requirements for non-operating holding companies.

The assessment of QBE's financial strength by various rating agencies has been reaffirmed during the year, with Standard & Poor's confirming our A+ financial strength rating for our main operating entities. Equivalent ratings have been confirmed by A.M. Best, Fitch and Moody's. The directors continue to ensure that the financial strength of all of QBE's operating entities is maintained at levels adequate to meet the requirements of our business counterparties, regulatory authorities and rating agencies.

During 2006 we completed a number of acquisitions which were mainly funded from internal sources, and we also amended our Group structure to ensure flexibility for future

growth and flow of funds. The major fundraising activity in 2006 was the raising of the \$750 million of long term perpetual securities that receive capital credit from regulatory and rating agencies. These securities assisted in further strengthening our financial flexibility at an individual entity and Group level.

The recently announced acquisitions of Praetorian Financial Group and the Winterthur US operations for a purchase price of approximately US\$2.0 billion will add significant scale to our US operations and are expected, subject to regulatory approvals, to be completed in the second quarter of 2007. We have a number of options to fund these acquisitions. Funding will be from existing sources and a combination of new debt and equity, at levels to ensure that QBE maintains its key financial ratios and meets our rating agency and regulatory benchmarks.

In support of our capital needs for recent acquisitions and expected growth, the directors have secured suitable underwriting arrangements for reinvestment of the next three dividend payments into QBE shares. The capacity to fully reinvest our dividends, together with the current levels of capital, expected future profits and the structure of our debt securities, should enable us to finance our normal level of growth and future acquisition activity.

#### DIVIDEND PER SHARE

95.0 cents

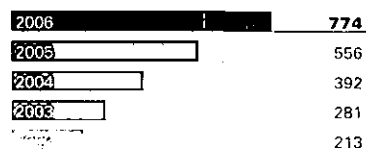
Up **34%** from last year

#### DILUTED EARNINGS PER SHARE

173.5 cents

Up **32%** from last year

#### DIVIDEND PAYOUT \$M



Up **39%** from last year



QBE's performance and record profits in 2004 and 2005, during a period of the highest level ever of catastrophe losses experienced by the industry, confirms the Group's conservative approach to risk management and reinsurance purchasing.

As in previous years, the annual report includes a number of statements on our corporate governance structure and risk management framework. QBE has demonstrated over many years that it has an effective risk management structure and a clear focus on key profit drivers. The insurance and reinsurance industry is subject to the potential impact of increasingly volatile and extreme weather patterns as evidenced by the US and Gulf of Mexico hurricane activity in 2004 and 2005. We note the considerable debate on climate change and generally support endeavours to mitigate its possible effect. We have adopted practices in our businesses to support governments, individuals and organisations in managing and reducing environmental risk. One of the most significant issues we face is the implication of climate change and the effect it may have on our business, such as the potential underestimation of the impact of catastrophic events. QBE's performance and record profits in 2004 and 2005, during a period of the highest level ever of catastrophe losses experienced by the industry, confirms the Group's conservative approach to risk management and reinsurance purchasing. We continue to research the impact of climate change and to adapt our strategy when appropriate. The details of our risk management approach are set out on pages 18 and 19 and in the Group's corporate governance statement on pages 49 to 50 of this report.

QBE has a strong focus on staff development, succession planning and the provision of adequate incentives to reward and retain our quality people. In accordance with increased reporting requirements, the annual report includes extensive detail on the Group's remuneration practices, including at risk pay through incentives and deferred compensation entitlements, particularly for senior staff members. The QBE staff incentive schemes are based on pre-agreed financial targets, mainly return on equity, closely aligning the schemes with the interests and expectations of shareholders. The incentives for our senior staff incorporate deferred equity and option allocations for achieving financial performance hurdles and are structured to encourage long term commitment to QBE. The value of deferred equity and options are directly related to QBE's share price.





Temple of Sinawa, Zion National Park, United States

The majority of our incentive schemes are based on achieving a targeted return on opening shareholders' funds using the seven year spread basis of accounting, which allocates realised and unrealised gains on equities and investment properties evenly over a period of seven years. The net profit after tax for 2006, using the seven year spread basis of accounting, was \$1,435 million compared with \$1,044 million last year. Return on opening shareholders' funds, adjusted for dividends and share capital issued during the year, was 29.3% compared with 26.3% last year. *Details of the incentive arrangements* and senior management remuneration are set out in notes 27 and 28 to the financial statements and in the remuneration report which forms part of the directors' report.

QBE has in place efficient and effective budgeting and planning processes which are designed to minimise risks relating to our insurance and investment operations, with the aim of protecting the interests of all stakeholders. The directors support management's plans to reduce insurance risk for both aggregate exposure and claims frequency by purchasing extensive reinsurance protections. The directors also support a low risk strategy for investment of policyholders' and shareholders' funds. While economic conditions for the majority of the international markets in which QBE operates are stable at present, our prospects for the future have been and will continue to be influenced by competition and changes in global, economic and environmental conditions. Your directors and management will carefully monitor these conditions, and will review and amend our strategies and plans if appropriate.

Over the next few years, the global insurance industry will continue to be subject to regulatory change in relation to supervision and reporting. The full effect of convergence of International Financial Reporting Standards ("IFRS"), European Solvency II initiatives and reforms of the US National

Association of Insurance Commissioners will have a major impact on all markets. In Australia, the APRA stage 2 reforms are largely complete and the first phase of IFRS was implemented in 2005. APRA is in the process of finalising its standards for conglomerates which may have longer term implications for the domicile of the Group. QBE is currently well placed to comply with the new regulatory frameworks.

We continue to support management's proven and successful strategy and plans for growth through acquisition and product and geographic diversification. This strategy has been vindicated with outstanding results over many years and a consistent increase in QBE shareholder wealth.

My directors and I acknowledge the significant achievement and hard work of our many staff around the world. In particular, I congratulate the CEO, Frank O'Halloran, and his management team for their contribution to producing another outstanding result. We recognise their dedication and commitment to customer satisfaction, ensuring employee motivation and upholding a culture of integrity with a clear focus on achieving an increase in the long term wealth of shareholders.

At the Annual General Meeting in April 2007, The Hon Nick Greiner AC will retire from your board of directors after 15 years of continuous supervision and dedication to building QBE into a global insurance and reinsurance enterprise. Nick's teamwork and counsel have been invaluable, and I sincerely thank him on behalf of the QBE family. I also wish to acknowledge the support of my fellow directors, for the benefit of their experience and their commitment to the supervisory task. Finally, I take this opportunity to welcome our recently appointed director, Duncan Boyle, who joined us in September 2006.

**John Cloney**  
Chairman

# Historical review

## 10 YEAR HISTORY

FOR THE YEAR ENDED 31 DECEMBER <sup>(1)</sup>		2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Gross written premium	\$M	<b>10,372</b>	9,408	8,766	8,350	7,723	6,793	4,406	2,877	2,409	2,054
Gross earned premium	\$M	<b>10,069</b>	9,171	8,571	7,816	7,197	6,298	4,399	2,692	2,266	1,902
Net earned premium	\$M	<b>8,158</b>	7,386	6,781	6,036	5,642	4,634	3,456	2,204	1,914	1,609
Claims ratio	%	<b>55.8</b>	59.9	61.3	63.3	67.6	76.6	71.2	70.1	68.1	68.6
Commission ratio	%	<b>17.0</b>	16.9	17.5	18.2	17.7	20.2	18.3	19.9	18.3	17.1
Expense ratio	%	<b>12.5</b>	12.3	12.4	12.3	12.4	12.8	13.0	13.9	13.9	13.8
Combined operating ratio	%	<b>85.3</b>	89.1	91.2	93.8	97.7	109.6	102.5	103.9	100.3	99.5

A lower than expected incidence of catastrophe claims and higher overall premium rates contributed to a superb technical underwriting result with a record combined operating ratio of 85.3% in 2006.

Investment income <sup>(2)</sup>											
before investment gains/losses	\$M	<b>609</b>	502	431	303	340	336	250	189	161	143
after investment gains/losses	\$M	<b>822</b>	718	519	413	189	349	310	243	164	163
Insurance profit (loss)	\$M	<b>1,788</b>	1,288	928	627	406	(119)	186	56	147	116
Insurance profit (loss)/net earned premium	%	<b>21.9</b>	17.4	13.7	10.4	7.2	(2.6)	5.4	2.5	7.7	7.2
Profit (loss)											
before income tax	\$M	<b>2,012</b>	1,523	1,115	765	311	(99)	220	156	157	170
after income tax and minority interest	\$M	<b>1,483</b>	1,091	857	572	279	(25)	179	132	141	131

The exceptional underwriting result combined with continuing strong investment returns gave rise to a record insurance profit of \$1,788 million and the highest insurance margin in the Group's history at 21.9% of net earned premium in 2006.

Number of shares on issue <sup>(3)</sup>	millions	<b>819</b>	794	745	672	615	585	429	395	383	374
Shareholders' funds	\$M	<b>6,283</b>	5,093	4,032	3,313	2,954	2,620	1,709	1,135	1,057	968
Total assets	\$M	<b>31,757</b>	29,665	25,036	20,443	20,567	18,611	13,948	8,559	5,964	5,065
Net tangible assets per share <sup>(4)</sup>	\$M	<b>5.95</b>	4.76	4.10	4.17	3.96	3.67	3.13	2.57	2.56	2.40
Interest bearing liabilities to shareholders' funds <sup>(4)</sup>	%	<b>37.6</b>	41.8	44.8	40.3	49.3	32.0	53.5	22.7	24.9	22.8
Basic earnings per share <sup>(5)</sup>	cents	<b>184.8</b>	142.5	123.1	86.5	42.7	(10.5)	42.6	33.8	37.3	35.6
Diluted earnings per share <sup>(5)</sup>	cents	<b>173.5</b>	131.5	109.3	77.5	43.4	(4.9)	40.7	33.8	37.3	35.6
Return on average shareholders' funds <sup>(6,7)</sup>	%	<b>26.1</b>	23.9	24.5	18.3	10.0	(1.1)	12.6	12.0	13.9	14.2
Dividend per share	cents	<b>95.0</b>	71.0	54.0	42.0	35.0	30.0	31.0	32.5	26.5	24.0
Dividend payout	\$M	<b>774</b>	556	392	281	213	155	132	130	101	88
Cash flow from operations	\$M	<b>2,039</b>	1,987	2,110	2,089	1,511	280	173	242	289	350
Total investments and cash <sup>(8,9)</sup>	\$M	<b>19,972</b>	17,597	14,975	11,823	11,504	9,183	7,334	5,232	3,600	3,238

The 36% increase in profit in 2006, the dividend reinvestment plans and conversion of hybrid securities during the year resulted in shareholders' funds increasing by 23% to \$6,283 million.

(1) Financial information for 2004 and subsequent years is presented in accordance with Australian equivalents to International Financial Reporting Standards ("AIFRS"). Financial information for 2003 and prior years has not been restated to AIFRS.

(2) Excludes amortisation and impairment of goodwill/intangibles.

(3) Reflects shares notified to the Australian Stock Exchange. Refer to note 25(A) to the financial statements.

(4) Excludes ABC securities for funds at Lloyd's.

(5) Assumes that all hybrid securities are fully dilutive.

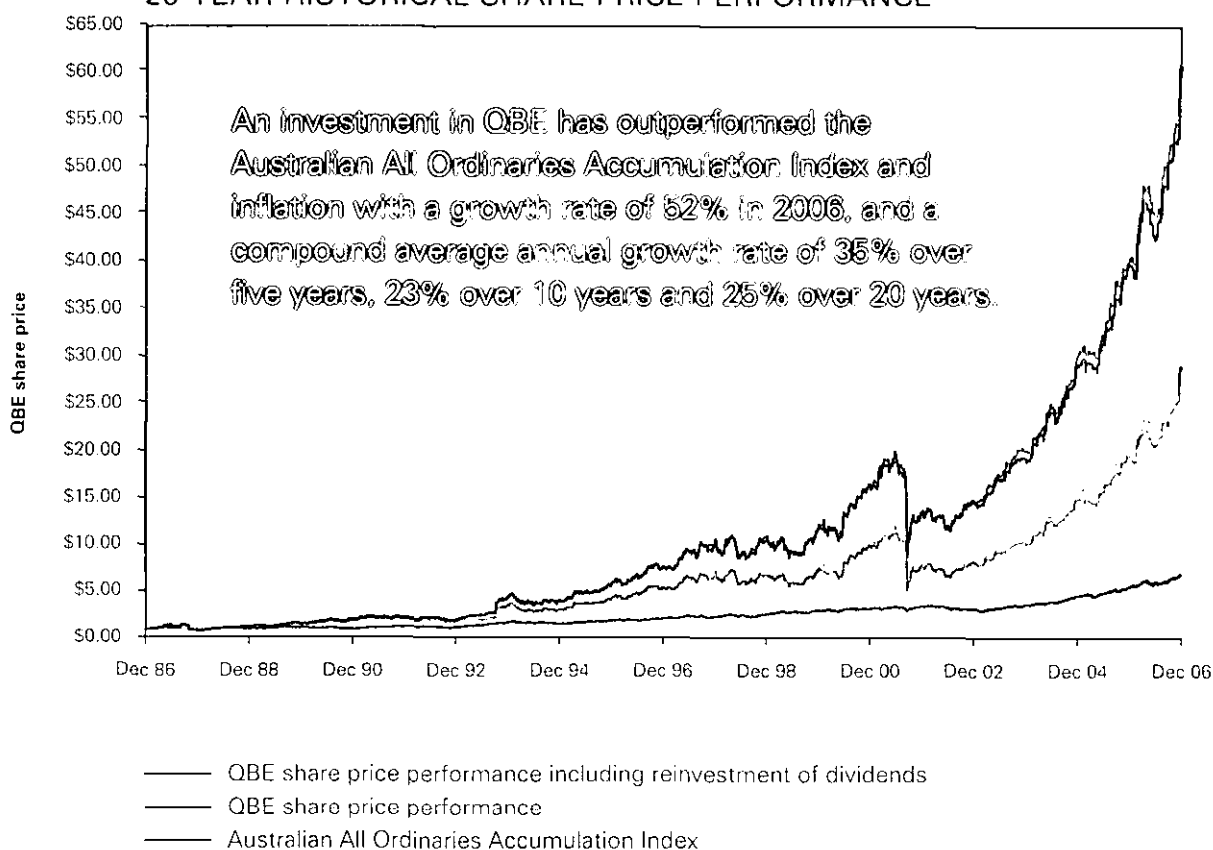
(6) 2004 return has been calculated with reference to AIFRS adjusted shareholders' funds of \$2,951 million at 1 January 2004.

(7) Includes convertible preference shares from 2000 to 2003 and the equity portion of hybrid securities issued in 2002 and 2004.

(8) Excludes ABC financial assets pledged for funds at Lloyd's.

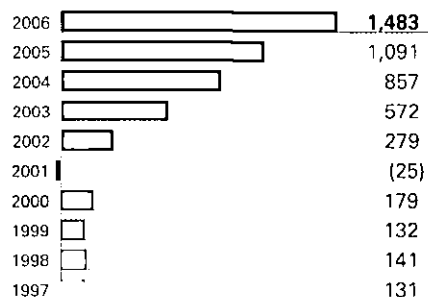
(9) Includes financial assets, cash and investment properties.

## 20 YEAR HISTORICAL SHARE PRICE PERFORMANCE



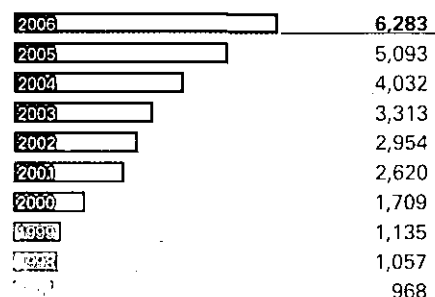
QBE's proven strategy of growth through acquisition and product and geographic diversification has been rewarded with outstanding results over many years and a substantial increase in wealth for QBE shareholders.

### NET PROFIT AFTER INCOME TAX \$M



Up **36%** from last year

### SHAREHOLDERS' FUNDS \$M



Up **23%** from last year

# Chief executive officer's report

I am pleased to report another year of achievement for QBE in which we substantially exceeded our profit targets and further strengthened our position in the global insurance market.

Net profit after tax increased by 36% to \$1,483 million and insurance profit before tax increased by 39% to \$1,788 million.

Insurance conditions continued to be favourable, particularly for commercial lines of business and reinsurance. We achieved an overall average increase in premium rates for all portfolios of around 6%. In contrast to 2005, we experienced relatively few catastrophe losses, however there was an increased incidence of large individual risk claims. These conditions, combined with our conservative approach to managing risk and continued strong investment markets, have resulted in the highest insurance margin in the history of the Group at 21.9% of net earned premium compared with 17.4% last year.

Cash flow from operations was again very strong at \$2.0 billion, unchanged from last year. The cash flow was after the payment of claims from the 2005 catastrophes, higher income tax payments and the funding of pension deficits in the UK and Australia.

Income tax expense reduced from 28% of profit before tax to 26%. This was due to higher profits earned in lower tax countries including Bermuda, the base for our captive reinsurer, Equator Reinsurances Limited ("Equator Re").

2006 has again been another busy year for acquisitions to increase profit and meet premium growth targets going forward. In particular, we:

- acquired the OneBeacon agriculture division in the US with an expected annualised gross written premium of \$115 million;
- acquired Nordic Aviation Insurance in Denmark with an expected annualised gross written premium of \$15 million;

- hired a general aviation underwriting team for our new Lloyd's syndicate 5555 with an expected annualised gross written premium of \$210 million;
- acquired, subject to regulatory approval, Praetorian Financial Group and its licensed insurance subsidiaries in the US with an expected annualised gross written premium of \$1,800 million; and
- hired a marine team in Sweden and established a branch office with expected annualised gross written premium of \$20 million.

Since the end of 2006 we have acquired the Winterthur US operations including their insurance subsidiaries trading mainly under the names of General Casualty and Unigard, which will add an expected annualised gross written premium of \$1,850 million. We have also acquired Seguros Cumbre SA de CV in Mexico. These acquisitions are subject to regulatory approvals.

We expect the recent US acquisitions to produce gross written premium of \$2.5 billion in 2007 and \$3.8 billion in 2008.

The acquisitions of the Praetorian Financial Group and Winterthur US will significantly increase our scale in the US and are expected to produce annualised profits in the first full year of operations of around \$380 million after tax and estimated funding costs and before synergies. Our current estimate of the synergies from these two acquisitions before the end of 2008 is \$50 million after tax. At this stage, we anticipate consolidating Praetorian Financial Group from 1 April 2007 and Winterthur US from 1 June 2007.

The proposed funding of these acquisitions and the impact on capital adequacy are explained in the chairman's report.

## GROUP KEY RATIOS

		HALF YEAR TO 30 JUN 2006	HALF YEAR TO 31 DEC 2006	FULL YEAR TO 31 DEC 2006	HALF YEAR TO 30 JUN 2005	HALF YEAR TO 31 DEC 2005	FULL YEAR TO 31 DEC 2005
Gross written premium	\$M	5,656	4,716	10,372	5,123	4,285	9,408
Gross earned premium	\$M	4,932	5,137	10,069	4,331	4,840	9,171
Net earned premium	\$M	3,998	4,160	8,158	3,506	3,880	7,386
Claims ratio	%	58.3	53.3	55.8	61.0	58.9	59.9
Commission ratio	%	17.6	16.4	17.0	17.0	16.8	16.9
Expense ratio	%	12.0	13.0	12.5	12.3	12.3	12.3
Combined operating ratio	%	87.9	82.7	85.3	90.3	88.0	89.1
Insurance profit to net earned premium	%	18.7	25.0	21.9	16.7	18.1	17.4
Return on average shareholders' funds	%	22.2	30.1	26.1	24.1	24.1	23.9

## INSURANCE PROFITABILITY

The Group's insurance profit increased from \$1,288 million last year to \$1,788 million. Insurance profit comprises the underwriting result plus investment income on investments set aside to meet our liabilities to policyholders. The improvement in insurance profit followed a reduction in catastrophe claims and higher premium rates. Partly offsetting these positives were higher large individual risk claims and an increase in the level of risk margins to maintain the probability of adequacy of the outstanding claims provision at 94.6%, slightly above the top end of our internal target range of 85% to 94%.

The Group's combined operating ratio (total of claims, commissions and expenses as a percentage of net earned premium) was 85.3% compared with 89.1% last year. All insurance divisions produced strong underwriting profits and the substantial majority of our products and countries around the world were profitable. As a percentage of average shareholders' funds, insurance profit increased from 28.2% last year to 31.4%.

Total investments and cash set aside to meet insurance liabilities and the Group's capital requirements increased from \$17.6 billion to \$20.0 billion, assisted by the considerable cash flow from operations. The acquisitions made in 2006 and early 2007 will significantly increase these invested funds to around \$28 billion by the end of 2007.

Gross written premium increased by 10% to \$10,372 million, mainly from the acquisitions made in 2005, a continued high retention of business and the overall increase in premium rates. Gross and net earned premium growth in Europe were adversely affected by the significant appreciation of sterling against the US dollar for business written in US currency. New business growth was less than anticipated in a number of classes because of competition and our unwillingness to write business at premium rates that did not meet our profit targets. Premium rates for our major non-US property and liability portfolios declined with further rate reductions expected in 2007. However, property and marine insurance and reinsurance products exposed to catastrophes in the US and the Gulf of Mexico experienced substantial premium rate increases. QBE's businesses outside Australia contributed 76% to the Group's gross written premium.



### NET PROFIT AFTER INCOME TAX

**\$1,483M**

Up **36%** from last year

### INSURANCE PROFIT

**\$1,788M**

Up **39%** from last year

### COMBINED OPERATING RATIO

2006	85.3%
2005	89.1%
2004	91.2%
2003	93.8%
2002	97.7%

QBE's net exposure to major catastrophes before tax continues to decrease with the 2006 maximum event retention from the largest single realistic disaster scenario being 4.0% of net earned premium at year end compared with 4.3% last year.



Net earned premium increased 10% to \$8,158 million in line with growth in gross earned premium. This was less than our target of 12.5% growth due to higher than anticipated reinsurance costs and the opportunity to purchase covers to further reduce our exposure to large claims and protect profits.

Our reinsurance operations generated \$1,470 million of gross written premium compared with \$1,523 million last year. The combined operating ratio from this business was 87.9% compared with 102.2% last year. This was due to the much lower level of catastrophes. Despite the volatility in profits caused by catastrophes, our reinsurance operations have been a significant contributor to profit over a number of years. There were substantial premium rate increases for most reinsurance classes, however, this did not have a large impact on written premium as we chose to reduce our reinsurance exposures in 2006, particularly to US and Gulf of Mexico catastrophe risks.

The Group's cost of reinsurance protection as a percentage of gross written premium decreased from 19.0% to 17.8%, even though we incurred significant rate increases on the protections purchased for our reinsurance, marine and energy operations. The cost of reinsurance is made up of 43% proportional reinsurance mainly for Australia and US programme business, and 57% catastrophe and other excess of loss reinsurance. QBE's net exposure to major catastrophes before tax continues to decrease with the 2006 maximum event retention from the largest single realistic disaster scenario being 4.0% of net earned premium at year end compared with 4.3% last year.

Gross claims incurred as a percentage of gross earned premium reduced from 73.5% to 54.9%. The reduction in the gross claims ratio reflects the lower catastrophe claims and the continuation of a low frequency of claims on most of our portfolios. Net claims above \$2.5 million from catastrophes and large individual risk losses in 2006 were 10.0% of net earned premium compared with 11.7% last year. The net cost of catastrophes and large individual risk claims in 2006 was well within the allowances included in our business plans. The net claims ratio decreased from 59.9% to 55.8%. The 2005 results benefited from reinsurance recoveries on the large catastrophes whereas our reinsurers earned significant profits from the absence of catastrophes in 2006.

The commission ratio increased from 16.9% to 17.0% reflecting a change in the mix of business during the year, particularly the growth in the Americas and our Lloyd's operations where commission ratios are higher, offset partly by the benefits from the acquisition of intermediaries in Australia. The Group's expense ratio increased from 12.3% to 12.5% mainly due to higher IT costs for new systems in many of our operations around the world and the acquisition of intermediaries in Australia which increased the expense ratio and reduced the commission ratio by 0.2%.

#### INVESTMENT INCOME

Investment income net of borrowing costs and investment expenses increased from \$718 million to \$822 million. Our short duration fixed interest investment portfolio, increasing interest yields, strong cash flow from operations and improved equity markets benefited investment income during the year. Gross investment income was \$985 million compared with \$843 million last year. The gross investment yield was 5.2%, unchanged from last year. Lower equity gains in 2006 compared with 2005 were offset by higher interest yields on increased investment funds. We took the opportunity to lock in the majority of our equity gains early in the fourth quarter, in line with our absolute return criteria. Whilst equity returns overall were strong producing a 12.5% yield, they were less than market benchmarks due to the derivative protections. The yields achieved reflect our relatively low risk investment strategy.

We continue to maintain a strategy of short duration on cash and fixed interest investments with an average maturity at the end of 2006 of 0.4 years. Since year end, duration is slightly longer and may increase further in the second half of 2007 if we consider interest rates have reached their peak.

We also continued our policy of investing in highly rated fixed interest securities and value equities. Our weighting in listed equities increased from 3.6% of total investments and cash at 31 December 2005 to 8.6% at 31 December 2006.

#### IMPACT OF EXCHANGE RATE MOVEMENTS

We continue to match liabilities with assets of the same currency as far as practical. The nature of our business and our significant offshore operations, particularly in the UK



Geikie Gorge National Park, Western Australia

and US, means that from time to time we will have slight mismatches. The impact of exchange rate movements for the year was a net gain of \$18 million (2005 \$3 million). Interest rate differentials from hedging our substantial overseas shareholders' funds into Australian dollars are included in fixed interest investment income.

#### REINSURANCE RECOVERIES

Reinsurance recoveries on outstanding claims reduced from \$4,213 million at 31 December 2005 to \$3,624 million. The reduction is due to recoveries from the 2005 catastrophe claims. Reinsurance recoveries on incurred but not reported claims included in this amount were \$1,567 million compared with \$1,627 million last year. We continue to maintain strict controls over our reinsurance counterparties which is evidenced by our consistently low level of bad debt write-offs over many years. We maintain a conservative allowance for doubtful reinsurance recoveries of \$243 million compared with \$239 million at the end of last year.

#### CLAIMS DEVELOPMENT TABLES

Note 22 in the annual report includes an undiscounted net claims development table for accident years 2001 to 2006. Our claims incurred and other claims statistics are maintained on either an accident year or underwriting year basis for each product, business unit and operating entity. For our overseas operations, they are converted into Australian dollars using exchange rates at the end of the current financial year. With operations in 44 countries, hundreds of different products, various reinsurance arrangements and with the Group's risk tolerance managed on a net basis, it is not considered meaningful or practicable to provide claims information other than on a consolidated net accident year basis.

In previous annual reports, we reported an upgrade to US long tail casualty claims for 2001 and prior years mainly for our Limit operation, acquired in August 2000, and our US operations. In 2002, we ceased underwriting the business that caused this deterioration. The US casualty development primarily relates to the Enron, Worldcom and financial laddering claims (written in the UK) and the casualty facultative portfolio (written in the US). Since 2001 we have experienced improved market

conditions. In addition, we have cancelled and will continue to cancel non-performing segments of our business to improve overall returns. These factors have resulted in a lower claims frequency. The positive runoff of all accident years reflects our conservative claims provisioning which resulted in the release of risk margins as the claims were settled below central estimates. The 2006 and prior accident years include risk margins which will be released over time if our claims continue to be settled within central estimates.

#### CAPTIVE REINSURER

Included in note 37 to the financial statements are the results of Equator Re, our captive reinsurer. Equator Re provides excess of loss protections for most of QBE's subsidiaries around the world below the retentions deemed appropriate for the Group. Equator Re also participates on a number of the Group's excess of loss and proportional reinsurance protections placed with external reinsurers as well as proportional reinsurance from wholly owned operations in Europe. The exposures written by Equator Re are included in the Group's maximum event retention which is the Group's estimated net loss from its largest single realistic disaster scenario.

Equator Re has generated significant risk margins for the Group as well as producing an underwriting profit in each year since 2002. The underwriting profit for 2006 was \$100 million compared with \$30 million last year. The increase in profit reflects the lower incidence of catastrophe claims in 2006, partly offset by an increase in large individual risk claims and an increase in risk margins in outstanding claims. Gross written premium was up 155% to \$901 million and net earned premium increased 82% to \$538 million. Each of the operating divisions' reinsurance costs includes the amounts reinsured to Equator Re and these amounts are eliminated in the overall Group results.

For 2007, we expect Equator Re will write gross written premium of over \$1.2 billion with the increase coming from new excess of loss and proportional reinsurance from the divisions. Its net exposures are expected to remain substantially unchanged as the Group has purchased additional reinsurance protections for catastrophe losses.

# 2007 targets

## GROSS WRITTEN PREMIUM

**\$13,500M**

## NET EARNED PREMIUM

**\$11,400M**

## GROSS INVESTMENT YIELD

**At least 5.5%**

## INSURANCE PROFIT

**Around 18%  
of net earned  
premium**

## NET PROFIT AFTER INCOME TAX

**To increase by  
at least 20%**

## OUTLOOK

The acquisitions made in 2006 and early 2007 will benefit gross written premium growth in 2007 and 2008. Subject to regulatory approvals, the Praetorian Financial Group and Winterthur US acquisitions are expected to be consolidated effective from 1 April 2007 and 1 June 2007 respectively. Organic growth is expected to be slightly in excess of lapsed business and a continued high retention of customers is likely to be offset by lower premium rates, currently estimated to reduce by an overall average of 3%. At current exchange rates, we expect gross written premium to increase by close to 30% in 2007 to \$13.5 billion and net earned premium by close to 40% to \$11.4 billion. As the recent acquisitions will be consolidated for a full 12 months in 2008, we are currently targeting growth in gross written premium and net earned premium for 2008 of 15%.

The reinsurance ratio for 2007 is expected to reduce from 17.8% in 2006 to around 15% of gross written premium, assuming a normal level of catastrophes. The reduction is primarily due to the lower reinsurance requirements of the two recent acquisitions in the US and the increased participations by Equator Re. The Group's maximum event retention as a percentage of net earned premium will be lower than 2006 due to the acquisitions and additional catastrophe covers purchased to protect Equator Re. We have placed our 2007 reinsurance protections at costs in line with 2006.

The risk profile of our reinsurance operations was reduced in 2006 as a result of our experience from the US hurricanes in 2005. This was to improve the reward for the significant catastrophe risks that we underwrite. We anticipate no changes in our risk profile in 2007 other than a reduction in the net retention from our largest single realistic disaster scenario as a percentage of net earned premium. Changes to the portfolio mix following the recent acquisitions are expected to provide greater diversity and spread of risk in the US.

Our analysis of the Group's claims ratio between attritional, large risk and catastrophe claims indicates that the 2007 business plan allowances for large risk and catastrophe claims substantially exceed the amounts incurred in each of the past 10 years, including 1999 and 2005 which are recognised as the worst years on record for frequency and severity of insured catastrophe losses. These allowances are around four times the net retention from our largest single realistic disaster scenario.

The combined commission and expense ratio is targeted to remain unchanged in 2007 including recent acquisitions. We are targeting a slight reduction in 2008 due to synergies from acquisitions and the implementation of new IT systems in many countries throughout the world.

The gross investment yield is targeted to be in excess of 5.5% for 2007. We do not expect stock markets to improve at the same rate as the past three years and we have assumed a 4% capital appreciation on equities. The increase in interest rates over the past year on our substantial US and UK investment portfolios will assist our expectations for higher investment income yields. Using current exchange rates, net invested funds are expected to be around \$24 billion by 31 December 2007 as a result of the acquisitions and anticipated strong cash flow.

Income tax expense is expected to be around 26% of pre-tax profit.

The Group's probability of adequacy of outstanding claims is 94.6%, slightly above the top end of our internal target range of 85% to 94%. In addition, our provision for unearned premium includes a significant allowance for large risk and catastrophe claims in 2007. These factors, together with the recent acquisitions and our current low frequency of claims, give us confidence that we are able to achieve an insurance profit of around 18% and increase net profit after tax by more than 20% in 2007. The achievement of these targets is subject to:

- large risk and catastrophe claims not exceeding the significant allowance in our business plans;
- no significant reduction in premium rates;
- no significant fall in equity markets and interest rates;
- no material movement in current exchange rates; and
- no material change to key inflation and economic growth forecasts.



## SUMMARY

QBE's results for the past year substantially exceeded our targets due to overall average premium rate increases being slightly higher than anticipated and a relatively benign year for catastrophe claims. The results are after a substantial increase in large individual risk claims and an increase in the dollar value of risk margins included in outstanding claims. Importantly, QBE's attritional claims ratio remains low for the substantial majority of classes of business written around the world.

QBE has completed 2006 with risk margins in outstanding claims providing a probability of adequacy of outstanding claims which is slightly in excess of the high end of our internal target range. The increase in risk margins in outstanding claims in recent years is largely a result of the increase in the Group's exposure to non-US long tail classes of business and the growth in business. The probability of adequacy of the Group's outstanding claims provision will vary from time to time depending on the mix of short, medium and long tail business and economic and industry conditions such as latency claims, claims inflation, interest rates and foreign currency exposures.

We have again been very successful with our acquisition activity in 2006 and early 2007. The two recently announced large acquisitions in the US and the acquisition in Mexico were again at prices which are projected to be earnings per share accretive in 2007. The acquisition of the Praetorian Financial Group will increase the specialist insurance programme business written through managing agents in the US from \$1.4 billion to \$3.1 billion in a full year or around 50% of our Americas gross premium income. The QBE team in the US has produced excellent results from this type of business in the past four years. The acquisition of Winterthur US increases the business written through independent and in-house agents in the US from \$0.4 billion to \$2.2 billion in a full year. We anticipate our reinsurance operation in the US to remain at its current size of around \$0.4 billion of gross written premium. Our focus in the Americas in 2007 and 2008 will be to integrate the new acquisitions into the QBE culture and achieve the expected profits after tax and synergies previously mentioned.

We will continue to pursue our strategy of growth by acquisition using our established criteria. We are currently looking at small bolt on opportunities in Latin America, continental Europe, Asia and Australia. The acquisition of Limit in August 2000 was a strategic move to build our business in the UK. The two recent acquisitions in the US were also carefully timed and are strategic to our long term plans. They are at prices which meet our long established criteria for acquisitions. We have converted close to 100 acquisitions over the past 25 years and we now have experienced teams in each division who understand QBE's approach to acquisitions. QBE has a well diversified spread of business, both geographically and by product. On an annualised basis, our US and UK operations will be around 40% and 38% respectively of QBE's total worldwide gross written premium. Australia will fall below 20% but this was not unexpected given that Australia represents less than 1.5% of the world's non-life premium income.

QBE's diversification and its comprehensive approach to risk management have enabled it to achieve significantly improved insurance profitability in recent years. We continue to lead terms and conditions on most business in the countries in which we operate. Our low attritional claims ratios and our substantial allowances for large risk and catastrophe claims in our business plans should mean that we can absorb the anticipated overall average price reductions of around 3% in 2007 and meet our profit targets.

We continue to have a low turnover of senior staff and have quality employees capable of filling more senior roles in the Group. All our operations around the world understand that they must operate within the parameters of our measurable and approved business plans. They have a very strong focus on business acumen and increasing wealth for our shareholders. These factors and the acquisitions made in 2006 and 2007 to date also give us confidence about our future performance.

The excellent 2006 results and our positive outlook have been achieved from our focused, disciplined and professional team of around 7,900 staff which will increase to over 10,000 as a result of the recent acquisitions. I appreciate the enormous support and loyalty that I receive from my fellow employees and their significant contributions over the past year. I also thank our directors for their encouragement and the support that they have provided on the many initiatives that we have undertaken, particularly the two recent major acquisitions.

I look forward to working with the QBE team to achieve our financial targets for 2007 and to build further shareholder wealth going forward.

**Frank O'Halloran**  
Chief executive officer

# Worldwide portfolio mix

## **Property**

QBE's property insurance products provide cover against physical loss or damage to assets for individuals and many types of retail, commercial and industrial ventures ranging from small to large value risks, being both rural and city based. Cover is generally available for fire and perils, consequential loss following business interruption, accidental damage and crime exposures. Through our operations in the US and Lloyd's, we also provide insurance protection to insurers and reinsurers against catastrophes and individual risk claims.

## **Liability (including professional liability)**

QBE is a leading provider of liability insurance solutions designed to protect businesses and officers against legal liabilities arising from their day to day operations. We have a keen focus on working with our customers to reduce the frequency of losses and we provide tailored solutions to enable effective risk and cost mitigation. We write a large international account and a limited portfolio of liability business throughout the US, focusing mainly on small to mid-sized regional clients including home owners, farm owners and general liability for commercial operations.

## **Motor and motor casualty**

Our motor insurance products provide corporations, businesses and individuals with a comprehensive range of protections for their commercial and private vehicles which normally can be extended to incorporate third party liability coverage where appropriate. QBE generally targets specific motor market segments and territories. We are a leading insurer in the UK for standard and specialised motor fleets, including London buses, commercial bus and coach fleets, as well as "blue light" fleets comprising police, fire, ambulance and emergency services vehicles.

## **Workers' compensation**

QBE underwrites workers' compensation business usually for its own account or, in the case of some jurisdictions, as an agent of government based schemes. Workers' compensation insurance provides employers with financial protection against liabilities resulting from workplace injuries. Our focus is on rehabilitation of injured workers and helping them return to the workforce as quickly and effectively as possible. We also assist customers in improving workplace safety and reducing the risk of workplace injuries. QBE writes a diversified portfolio of workers' compensation business from corporate and industrial accounts to the domestic level for full-time and part-time household employees.

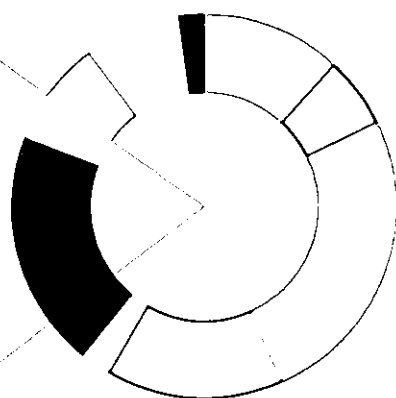
## **Marine and energy**

QBE is a lead underwriter in the marine and energy insurance sectors around the globe. In the marine segment, QBE provides coverage for hulls, hulls under construction, marine liabilities, protection and indemnity, cargo insurance and private pleasure craft insurance for the boating enthusiast. In the energy sector, we provide lead capacity for physical loss or damage and business interruption coverage, on risks as diverse as offshore oil and gas platforms, onshore oil wells and segments of the petrochemical industry.

## CONTRIBUTIONS BY REGION

FOR THE YEAR ENDED 31 DECEMBER	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		NET PROFIT AFTER INCOME TAX		COMBINED OPERATING RATIO	
	2006	2005	2006	2005	2006	2005	2006	2005
	\$M	\$M	\$M	\$M	\$M	\$M	%	%
Australia	2,491	2,431	2,051	2,015	387	360	82.9	83.6
Pacific Asia Central Europe	727	691	563	536	87	103	84.4	82.3
QBE Insurance (Europe)	2,502	2,558	2,209	1,954	385	314	88.8	90.0
Lloyd's division the Americas	2,711	2,236	1,644	1,743	374	213	82.1	94.5
Equator Re	1,941	1,492	1,153	843	109	62	89.7	92.9
Elimination – internal reinsurance	(901)	(353)	–	–	–	–	–	–
Group	10,372	9,408	8,158	7,386	1,483	1,091	85.3	89.1
Direct and facultative	8,902	7,885	7,006	6,152	1,382	1,116	84.9	86.4
Inward reinsurance	1,470	1,523	1,152	1,234	101	(25)	87.9	102.2
Group	10,372	9,408	8,158	7,386	1,483	1,091	85.3	89.1

## WORLDWIDE PORTFOLIO MIX



GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER			2006	2005
Marine, energy and aviation			11.7%	8.3%
Accident and health			6.1%	6.2%
Property			25.6%	26.9%
Motor and motor casualty			15.0%	13.7%
Financial and credit			2.6%	2.5%
Liability			19.9%	21.8%
Professional indemnity			9.0%	9.1%
Workers' compensation			8.1%	8.9%
Other			2.0%	2.6%

## OTHER INSURANCE RATIOS

FOR THE YEAR ENDED 31 DECEMBER	2006	2005	2004	2003	2002
	%	%	%	%	%
Premium growth					
Gross written	10.2	7.3	5.0	8.1	13.7
Net earned	10.5	8.9	12.3	7.0	21.8
Reinsurance ceded to gross written premium	17.8	19.0	20.3	21.7	21.1
Net written premium to gross written premium	82.2	81.0	79.7	78.3	78.9
Insurance profit to average shareholders' funds <sup>(1)</sup>	31.4	28.2	26.6	20.0	14.6

(1) 2004 comparatives are calculated with reference to the AIFRS adjusted shareholders' funds of \$2,951 million at 1 January 2004.

# Group financial targets and performance goals



## FINANCIAL PERFORMANCE

TARGETS*	ACTUAL
• Achieve an insurance profit margin of 16.0% to 17.0%	• Insurance profit margin of 21.9%
• Increase profit after income tax and diluted earnings per share by more than 10%	• Profit after income tax increased 36% and diluted earnings per share increased 32%
• Achieve a return on average shareholders' funds of more than 20%	• Return on average shareholders' funds of 26.1%
• Gross written premium growth of 10%	• Gross written premium increased 10.2%
• Net earned premium growth of 12.5%	• Net earned premium increased 10.5%
• Reinsurance ratio of 17% or less	• Reinsurance ratio of 17.8%
• Maintain expense ratio of 12.0% or less	• Expense ratio of 12.5%
• Tax rate of around 27%	• Tax rate of 26%
• Maintain Group capital adequacy multiple of more than 1.5 times APRA's minimum requirement for Australian licensed insurers	• Capital adequacy multiple of 2.4 times the minimum requirement
• Gross investment yield slightly in excess of 5.0%	• Gross investment yield of 5.2%

## NON-FINANCIAL PERFORMANCE

PERFORMANCE GOALS	ACTUAL
• Maintain overall premium rates at levels sufficient to achieve targeted attritional claims ratios	• Overall increase in average premium rates of 6%
• Maintain existing terms, conditions and deductibles	• Existing terms, conditions and deductibles substantially retained
• Further reduce risk profile of insurance business	• Lower maximum event retention ratio achieved
• Continue high retention of key staff and managers	• Very low turnover of key staff and managers
• Continue promotion of QBE's culture and essential behaviours	• OPENUQBE programme extended
• Continue to effectively manage the impact of foreign exchange volatility	• Effective foreign exchange hedging – \$18 million net gain
• Achieve gross investment yield target with a low risk investment strategy	• Gross investment yield of 5.2%

\* Targets assume: large losses and catastrophes not exceeding the significant allowance in our business plans; no significant reduction in premium rates; no significant fall in equity markets and interest rates; no major movement in current exchange rates; and no material change to key inflation and economic growth forecasts.

## STRATEGY AND PLANNING

QBE has developed a business planning framework which ensures that there is a systematic and disciplined approach to planning throughout the Group.

The framework helps to:

- establish a clear direction and parameters for carrying on business in each operating division;
- build confidence in our ability to execute our corporate strategies and deliver against our business plans;
- more accurately project profitability and financial performance;
- improve *alignment* of internal resources with external opportunities;
- generate greater accountability and transparency in decision making; and
- target the reduction of uncertainty and volatility, thereby reducing the likelihood and impact of events that could threaten our ability to meet our business objectives.

## FINANCIAL PERFORMANCE

### TARGETS\*

- Achieve an insurance profit margin of 17.5% to 18.5%
- Increase profit after income tax by more than 20% and diluted earnings per share by more than 15%
- Achieve a return on average shareholders' funds of more than 23%
- Gross written premium growth of close to 30%
- Net earned premium growth of close to 40%
- Reinsurance ratio of around 15% of gross written premium
- Achieve a combined commission and expense ratio of 29.5% or less
- Tax rate of around 26% or less
- Maintain Group capital adequacy multiple of more than 1.75 times APRA's minimum requirement for Australian licensed insurers
- Gross investment yield slightly in excess of 5.5%

## OPERATIONAL PERFORMANCE

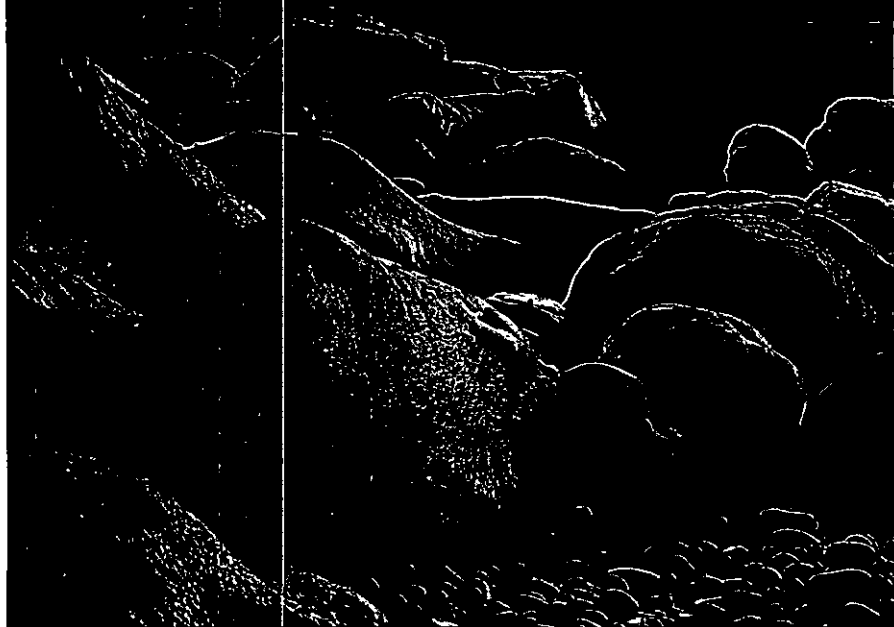
### PERFORMANCE GOALS

- Complete and integrate the acquisitions in the Americas
- Achieve targets and synergies from acquisitions
- Maintain attritional claims ratio at less than 47.5% of net earned premium
- Increase Equator Re's participation on external reinsurance programmes
- Further reduce risk profile of insurance business and maximum event retention ratio
- Continue high retention of key staff and managers
- Successful implementation of new IT systems in all divisions
- Achieve gross investment yield target with a low risk investment strategy

The QBE board of directors approves the Group's strategy and detailed business plans prepared by management and reviews actual performance against the plans. The strategy is consistent with shareholder expectations, our corporate financial profile, our organisational culture and our capacity to effectively manage risks. The strategy and plans form the basis for our risk tolerance within the Group.

Business plans are developed for all classes of insurance business, for our investment portfolios and for all support functions. The plans clearly document our strategy for achieving financial targets and performance goals within the limits set. Annual budgets included in the business plans form the basis for delegating authorities to all managers and staff with specific responsibilities, including underwriters, investment managers and claims managers.

Business plans are subject to detailed review by local and Group senior management. They are prepared annually and actual results are monitored regularly to identify adverse trends so that remedial action can be taken at an early stage. Regular reporting to both local and Group boards on performance against the business plans, including action plans to correct adverse variances, is a fundamental control within the Group.



# Risk management



1



2

- 1 **George Thwaites**  
Group chief risk officer
- 2 **Blair Nicholls**  
Group chief actuarial officer

Our ability to manage risk is central to the success of our business. Over time, we have developed processes and internal controls to identify and manage risks in all key areas of risk exposure. As risk management is a continuous process, our approach is targeted to ensure risk management is tailored to suit our business requirements whilst remaining within our risk tolerances.

## RISK STRATEGY

QBE's risk management strategy is underpinned by a number of robust processes which are aimed at reducing uncertainty and volatility and avoiding unwelcome surprises. All risks are subject to rigorous identification and evaluation throughout the business management cycle.

The Group risk management policy, strategy and framework are embedded in the Group head office and each of the divisions, providing a consistent approach to managing risk across the organisation. The implementation of risk management at the divisional level enables local management to use their specialised knowledge of each portfolio to ensure risks are mitigated at that level.

Risk tolerances are in place for each of the categories of risk faced by the Group:

- insurance risk;
- operational risk, including loss of key QBE people;
- acquisition risk; and
- funds management and treasury risks.

By evaluating risks against these predetermined tolerances, QBE is able to direct resources appropriately and manage risk to acceptable levels. Our internal capital modelling process enables assessment of the risk to reward profile of each business unit, and capital is allocated to reflect the past results and volatility of the business written. QBE's overall risk tolerance for each category of risk is defined in terms of the maximum pre-tax loss that the Group is prepared to accept whilst continuing to achieve profitability targets.

QBE applies a rigorous methodology to assess potential catastrophe claims, including the use of realistic disaster scenarios, commercial catastrophe loss models and in-house catastrophe loss assessment tools. The outcomes



Orpheus sunrise, Orpheus Island, Australia

of these assessments help to set the level of reinsurance required by QBE and, in conjunction with QBE's risk appetite, determine the amount of risk that is retained by the Group and in any one geographic region, business unit or for a particular peril. In 2006, the availability of reinsurance of a sufficiently high security rating and on reasonable terms has been an industry wide issue. QBE has taken steps to further improve the security and ongoing availability of reinsurance through the use of the Group security committee and a range of external and internal arrangements.

#### CLIMATE CHANGE

There is currently much debate on the issue of climate change and the potential impacts of increasingly volatile and extreme weather patterns and carbon emissions on the insurance and reinsurance industry. We note the considerable debate on the various reasons for climate change and generally support endeavours to mitigate its possible effect. Importantly, we focus on the implications of climate change on our business. One of the most significant risks is the potential for the underestimation of the impact of catastrophic events on QBE and the insurance industry. An inherent strength of the QBE Group is our high level of diversification which mitigates the potential impact of extreme weather events in any one part of the world. The success of QBE's strong risk management approach and conservative reinsurance purchasing is reflected in our record profit results in 2004 and 2005 during which the highest ever level of catastrophe losses was experienced by the industry. QBE recognises that insurance pricing and capital allocation models must be regularly updated to reflect the latest scientific evidence, population shifts, changing property values, extra costs incurred for goods and services from demand surge and short and long term seasonal weather forecasts. As a leading member of the Lloyd's market, QBE is participating in

the work currently being undertaken by the Lloyd's emerging risks team to improve the quality of catastrophe modelling to deal with the impacts of more frequent and severe weather related events.

#### REGULATORY DEVELOPMENTS

The flexibility of QBE's principles based risk framework allows for adaptation in the face of changes in the regulatory or business environment. Regulators, rating agencies and investors continue to converge in their focus on understanding the risks taken by insurers, how they control those risks and the capital required in order to provide adequate protection to policyholders and others. The core principles of the International Association of Insurance Supervisors, to which many regulators now subscribe, indicate the likelihood of further extension of risk based supervision. Significant changes are currently being implemented by many jurisdictions such as the European Solvency II initiatives targeted to be in place in 2009-10, the APRA stage 2 reforms which have been largely completed, except for those related to corporate groups, and the US National Association of Insurance Commissioners which is targeting various reforms by 2010.

Most of the major regulators overseeing the operations of the QBE Group have risk based supervisory methodologies and risk based capital models in place. Rating agencies also now either explicitly assess enterprise risk management in their rating process or include the key elements of risk management as part of their broader rating approach. Ongoing discussions with these stakeholders indicate that the QBE risk management framework meets expectations.

QBE continues to be committed to sound practical risk management in order to protect shareholders' and policyholders' interests.

# QBE people

QBE is committed to attracting, developing and retaining high quality employees.



**Jenni Smith**  
Group general manager HR

## EMPLOYEE NUMBERS

**7,900** people

Up from **7,790** last year

QBE Group is a global organisation currently operating in 44 countries with significant businesses in the key general insurance and reinsurance markets around the world. Over recent years, we have experienced strong growth through acquisitions of businesses, the latest being in Sweden, Denmark, Mexico and the US. We currently have more than 7,900 employees which will increase to over 10,000 employees on completion of our recent US acquisitions.

### OUR PEOPLE STRATEGY

Our people are selected for their ability, experience and 'can do' approach to their roles. The development and retention of our people as our intellectual capital is recognised as paramount for QBE to consistently achieve high business standards and ultimately deliver superior returns to shareholders. The Group's aim is to develop our own talent, leveraging off the experience of our highly skilled and experienced teams around the world through a range of development activities. QBE has an international reputation as a quality employer with a highly developed culture based on performance and reward. We have competitive remuneration structures in place which align employee performance with company and stakeholder objectives whilst also ensuring longer term commitment from our senior executives.

### QBE CULTURE, STANDARDS AND VALUES

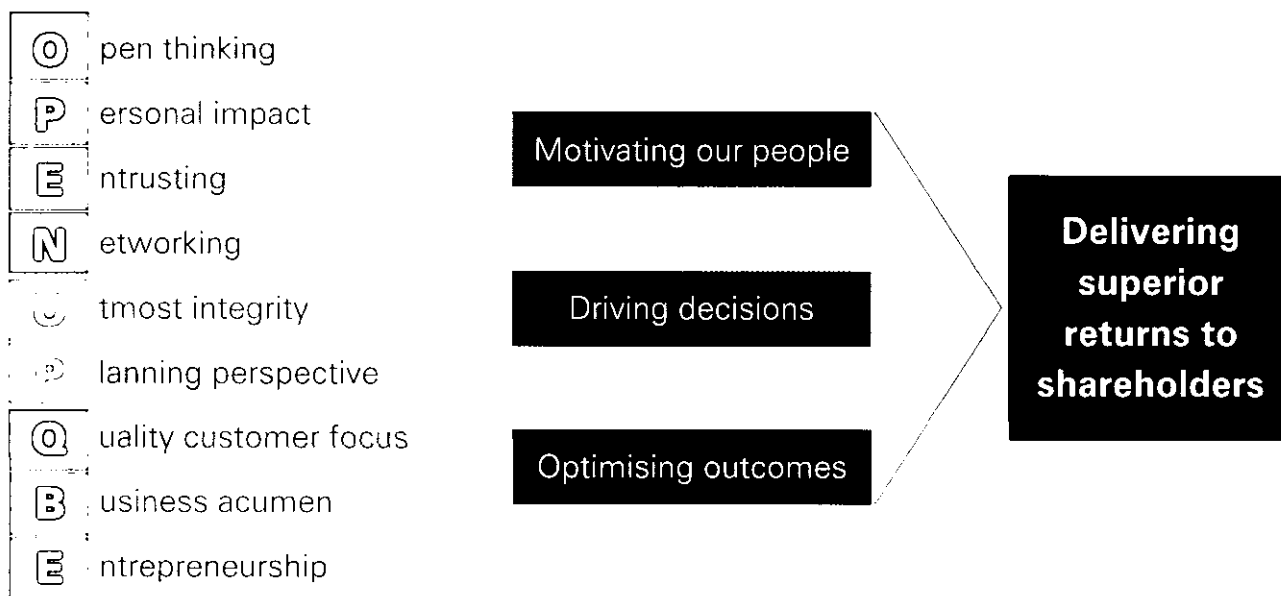
Underpinning our strategy of attracting, developing and retaining quality people is the OPENUPQBE programme which is actively promoted to staff across the Group. The programme, which was developed in 1994 with input from all divisions, has the full support of the Group board and the chief executive officer. It involves nine "essential behaviours" which form the basis of our business and leadership standards and illustrate the values which embody the QBE culture. These standards and values provide consistency in all key activities and create a common thread throughout our organisation. The strength of the QBE culture has provided a platform for the successful integration of the diverse teams from the many acquisitions over recent years.

### OPENUPQBE IN ACTION

The first OPENUPQBE programme was presented by Frank O'Halloran in 1995 and has since been extended to increase the capabilities and commercial awareness of staff in key functional areas and in so doing, delivers improved management leadership and business acumen. In 2006, the OPENUP Claims programme was implemented to demonstrate the application of the QBE essential behaviours to claims management. This has generated 19 business improvement projects around the Group within the Group's core philosophy of promptly paying valid claims. The content of the programme was written by senior managers in the business to provide rigour and credibility to the programme. By addressing key strategic and tactical issues within the Group through real business projects and case studies, OPENUP Claims has raised staff awareness of how we do business at QBE and has provided a forum to generate new ideas and build successful teamwork. The programme has enabled participants to demonstrate their commercial ability and implement tangible business improvements which positively influence QBE's key profit drivers and deliver superior returns to shareholders. The identification of region specific issues to be tackled through the programme's business improvement methodology has enabled each division to integrate the QBE essential behaviours into how they conduct their business locally.



## QBE NINE ESSENTIAL BEHAVIOURS



### PERFORMANCE MANAGEMENT, STAFF DEVELOPMENT AND SUCCESSION PLANNING

Our annual performance management process provides the forum for measuring performance and setting objectives, with most staff assessed against QBE's nine essential behaviours as outlined above. QBE is also committed to providing a range of personal development opportunities for employees to realise their full potential and progress within the organisation. Our principal goal is to ensure that the best people occupy the key positions at all levels of the business and that robust succession plans are in place for each of those roles. Key roles throughout the organisation have been analysed and documented using a formalised succession management framework. A pool of potential candidates has been identified against this matrix of key roles, and is regularly assessed in terms of current performance and future potential using a set of consistent measures. Succession plans are aligned to individual career aspirations and development activities are agreed to meet skills gaps.

### REMUNERATION AND REWARD

QBE operates in a competitive global market and our performance based remuneration and reward structures must take into account the diversity of individual roles and the complexity of each local operating environment. QBE aims to provide a mix of financial and non-financial rewards to attract, motivate and retain high performing 'can do' people, within a cost structure aligned to shareholders' interests and which is sustainable in the long term.

In order to encourage high levels of performance and to achieve our vision of increasing shareholder wealth, at risk incentive arrangements are in place for most staff worldwide through participation in short term incentive ("STI") arrangements. These arrangements reward staff when they achieve or exceed financial targets and/or meet personal performance objectives.

Our senior management group and other selected high performing individuals participate in an annual deferred compensation award, the Deferred Compensation Plan ("DCP"), with awards in the form of equity in QBE. The value of the DCP is linked to the future creation of shareholder wealth. It also assists in the retention of key staff. Under the DCP, participants are granted conditional rights to fully paid shares and options to subscribe for shares at market value. Participation in the annual equity award is contingent on meeting financial targets for STI purposes and there is a vesting period of a minimum of three years, other than for certain equitable circumstances, before the DCP shares and options are exercisable. Also central to our incentive arrangements is the Employee Share and Option Plan ("the Plan") which has been in place since 1981. Over 6,000 of our employees at all levels of the organisation now hold shares in QBE through the Plan. Details of the Plan and the DCP are set out in note 27 to the financial statements.

Our very low turnover of senior and middle management staff demonstrates the effectiveness of our remuneration and reward system and other retention policies.

# Group operations executive

The Group operations executive comprises the chief executive officer, the chief operating officer, the chief financial officer and the heads of the QBE insurance divisions. The key objective of this team is to build and control QBE's insurance business and to maximise opportunities available to the Group in the markets in which we choose to operate.

## VINCE McLENAGHAN

FANZIIF, AGE 47

Mr McLenaghan was appointed chief operating officer of the Group in 2006. He is also currently chief executive officer of Australia Asia Pacific ("AAP"). Mr McLenaghan has been in the insurance industry for 30 years. During his 24 years with QBE, he has served in a number of general management roles, including as managing director of our Asia-Pacific operations.

## NEIL DRABSCH

FCA, FAICD, FCIS, AGE 58

Mr Drabsch was appointed chief financial officer of QBE Insurance Group in 1994 and acts as deputy company secretary of QBE Insurance Group Limited. He joined QBE in 1991 and was the Group company secretary from 1992 to 2001. Mr Drabsch has over 40 years experience in insurance and reinsurance management, finance and accounting, including 24 years as a practising chartered accountant.

## FRANK O'HALLORAN

FCA, AGE 60

Mr O'Halloran was appointed chief executive officer in January 1998. He joined QBE in 1976 as Group financial controller. He was appointed chief financial officer in 1982, joined the board as director of finance from 1987 to 1994 and was director of operations from 1994 to 1997. Mr O'Halloran is a chartered accountant and has had extensive experience in professional accountancy for 14 years and insurance management for over 30 years.

## STEVEN BURNS

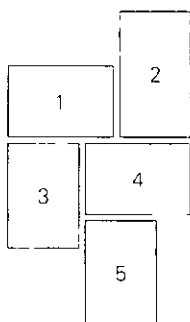
FCA, AGE 48

Mr Burns is currently chief executive officer of QBE's European operations. He is a chartered accountant and was finance director of the Janson Green managing agency at Lloyd's from 1987, prior to it being acquired by Limit in 1998. Mr Burns became chief executive officer of the Limit Group in August 2000. In September 2004 he was appointed chief executive officer of European operations as part of the restructure of our European company operations and Lloyd's division.

## TIM KENNY

NDBS, MICM, AGE 46

Mr Kenny is currently president and chief executive officer of QBE the Americas. He has over 24 years experience in the insurance industry including 13 years with QBE Group during which he has served as senior vice president, chief financial officer and treasurer in the Americas.



- 1 Vince McLenaghan
- 2 Frank O'Halloran
- 3 Tim Kenny
- 4 Neil Drabsch
- 5 Steven Burns



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# Operations overview

QBE is an international general insurance and reinsurance group underwriting most major commercial and personal lines classes of business through operations in 44 countries.

## AUSTRALIA PACIFIC ASIA CENTRAL EUROPE

### AUSTRALIA

General insurance operations throughout Australia providing all major lines of insurance cover for personal and commercial risks.

### PACIFIC ASIA CENTRAL EUROPE

General insurance in 25 countries in Asia, Pacific and Central Europe providing personal, commercial and specialist insurance covers, including professional and general liability, marine, corporate property and trade credit.

#### Major events impacting APACE operations in 2006 were:

- Significant storm activity in the region, particularly Cyclone Larry in Australia and typhoon activity in Asia.
- Acquisition of the remaining 50% of Concord underwriting agencies in July.
- Acquisition of Nordic Aviation Insurance Services in Denmark in April.
- Receipt of approval to open a liaison office in India.

		2006	2005
Gross written premium	\$M	3,218	3,122
Gross earned premium	\$M	3,132	3,093
Net earned premium	\$M	2,614	2,551
Combined operating ratio	%	83.2	83.3
Staff numbers		5,232	5,302

#### COUNTRIES OF OPERATION

Australia	Malaysia
Bulgaria	Moldova
China	New Caledonia
Czech Republic	New Zealand
Denmark	Papua New Guinea
Estonia	Philippines
Fiji	Singapore
French Polynesia	Slovakia
Hong Kong	Solomon Islands
Hungary	Thailand
Indonesia	Ukraine
Macau	Vanuatu
Macedonia	Vietnam

## EUROPEAN OPERATIONS

### QBE INSURANCE (EUROPE)

Insurance and reinsurance business in the UK and Ireland, and insurance business in mainland Europe. Results also include British Marine which was acquired by the Group in 2005.

### LLOYD'S DIVISION (TRADING AS LIMIT)

The largest manager and second largest provider of capacity at Lloyd's with capacity in 2007 of £1.1 billion, writing commercial insurance and reinsurance business in the Lloyd's market.

#### Major events impacting European operations in 2006 were:

- Establishment of a dedicated aviation underwriting team through the creation of syndicate 5555.
- Below average frequency and severity of catastrophe losses.
- Establishment of a branch office in Sweden.
- Integration of the British Marine acquisition.

		2006	2005
Gross written premium	\$M	5,213	4,794
Gross earned premium	\$M	5,061	4,643
Net earned premium	\$M	3,853	3,697
Combined operating ratio	%	85.9	92.1
Staff numbers		1,767	1,651

#### COUNTRIES OF OPERATION

Bermuda	Japan
England	Luxembourg
France	Scotland
Germany	Spain
Ireland	Sweden
Italy	



**KEY** ■ Australia Pacific Asia Central Europe □ Europe □ the Americas ■ Equator Re

## THE AMERICAS

General insurance and reinsurance business in the Americas. Head office is in New York with operations in North, Central and South America and Bermuda.

### Major events impacting the Americas in 2006 were:

- Successful negotiation of the acquisition of two significant property and casualty businesses in the US, being Praetorian Financial Group and Winterthur US Holdings. Both are expected to complete in the second quarter of 2007.
- Below average frequency and severity of catastrophe losses.
- Acquisition of the OneBeacon agricultural business, writing farm and ranch, commercial agricultural and companion lines in 12 states in the US.

		2006	2005
Gross written premium	\$M	1,941	1,492
Gross earned premium	\$M	1,876	1,435
Net earned premium	\$M	1,153	843
Combined operating ratio	%	89.7	92.9
Staff numbers		805	729

### COUNTRIES OF OPERATION

Argentina	Mexico
Bermuda	Panama
Brazil	Peru
Colombia	United States

## INVESTMENTS

Management of the Group's investment portfolio. Management of less than 2% of the Group's investments is outsourced.

### Major events impacting investment management in 2006 were:

- Continued increase in oil prices until August, at which point prices suddenly weakened.
- Commodity prices were generally strong.
- After 17 successive interest rate increases, the Federal Reserve in the US held interest rates in June.
- Equity markets experienced a major sell off in May, but ended the year on a strong note.

		2006	2005
Gross investment income	\$M	985	843
Net investment income	\$M	822	718
Fair value gains on equities	\$M	104	130
Staff numbers		49	41
Investments and cash	\$M	19,972	17,597

## EQUATOR RE

The Group's captive reinsurer, based in Bermuda. Equator Re provides excess of loss protection for the majority of the Group's subsidiaries around the world, as well as participating on a number of the Group's excess of loss and proportional reinsurances placed with external reinsurers.

A hardening retrocession market has made it difficult for insurers to access reinsurance protection with acceptable security at a reasonable price. Equator Re has enabled the Group to more effectively manage its reinsurance costs.

A below average frequency and severity of catastrophe losses has resulted in a significant increase in profit.

### COUNTRIES OF OPERATION

Bermuda

# Australia Pacific Asia Central Europe

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**Lavender sea,** Tasmania, Australia

APACE has general insurance operations in 26 countries in Australia, Asia-Pacific and Central Europe. The division provides personal, commercial and specialist insurance covers, including professional and general liability, marine, corporate property and trade credit.

# Australia Pacific Asia Central Europe

Australia Pacific Asia Central Europe ("APACE") produced another outstanding underwriting result with a combined operating ratio of 83.2% compared with 83.3% last year. This slight improvement is due to a continued low frequency of claims despite further overall average premium rate reductions. Insurance profit to net earned premium was an excellent 23.8% unchanged from last year. APACE consists of businesses in 26 countries, the substantial majority of which produced underwriting and insurance profits for the year.

Gross written premium increased 3% to \$3,218 million, gross earned premium for the year increased 1% to \$3,132 million and net earned premium was up 2% to \$2,614 million. Premium growth came from our continued high retention of customers and organic growth being slightly in excess of lapsed business, despite increased competition for most classes of business.

## KEY RATIOS – APACE

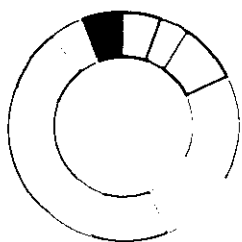
FOR THE YEAR ENDED 31 DECEMBER		AUSTRALIA		PACE		TOTAL APACE	
		2006	2005	2006	2005	2006	2005
Gross written premium	\$M	2,491	2,431	727	691	3,218	3,122
Gross earned premium	\$M	2,428	2,405	704	688	3,132	3,093
Net earned premium	\$M	2,051	2,015	563	536	2,614	2,551
Claims ratio	%	55.9	56.1	42.0	40.8	52.8	52.9
Commission ratio	%	11.8	12.7	20.4	18.7	13.7	14.0
Expense ratio	%	15.2	14.8	22.0	22.8	16.7	16.4
Combined operating ratio	%	82.9	83.6	84.4	82.3	83.2	83.3
Insurance profit to net earned premium	%	24.7	24.2	20.8	22.2	23.8	23.8

## PORTFOLIO MIX – AUSTRALIA

### GROSS EARNED PREMIUM

#### FOR THE YEAR ENDED 31 DECEMBER

	2006	2005
Professional indemnity	5.7%	5.2%
Credit and surety	4.0%	4.7%
Accident and health	8.6%	7.3%
Property	14.4%	16.6%
Motor vehicle	10.0%	9.3%
Travel	1.3%	1.8%
Householders	10.5%	10.6%
Compulsory third party ("CTP")	7.3%	7.4%
General liability	19.2%	18.7%
Workers' compensation	8.7%	8.2%
Marine and aviation	4.6%	4.6%
Other	5.7%	5.6%





## Australian operations

Our operations in Australia continue to produce excellent underwriting results with a combined operating ratio of 82.9% compared with 83.6% last year and an insurance profit of 24.7% compared with 24.2% last year. The improvement in results reflects the continued low frequency of claims, high customer retention and the *lapsing* of business which did not meet our profit criteria as a result of increased competition. The combined operating ratio is after the cost of Cyclone Larry, an increase in the number of large individual risk claims and an increase in the dollar value of risk margins in outstanding claims.

QBE is a market leader for most of the commercial products that we underwrite in Australia. The substantial majority of portfolios produced underwriting results ahead of plan. Premium rates for most portfolios decreased to reflect the improved claims experience and adjustments have been made by our various teams to ensure that we continue to retain our quality customers. Claims frequency continues to be at historically low levels for most portfolios.

Gross earned premium increased by 1% to \$2,428 million. The lower overall average premium rate reductions of around 3% in 2006 were more than offset by high customer retention and organic growth being slightly ahead of lapsed business. Net earned premium increased by 2% to \$2,051 million.

Many of our products improved underwriting profitability, particularly the workers' compensation, liability and trade credit portfolios. Our travel, rural and small to medium property portfolios were affected by Cyclone Larry and large individual risk claims. The NSW and Queensland compulsory third party and other portfolios produced lower but satisfactory underwriting results.

The continuation of a low frequency of claims in most classes of business has resulted in the net claims ratio decreasing from

56.1% to 55.9%. The acquisition of a number of intermediaries over the past two years helped reduce the commission ratio from 12.7% to 11.8%. However, the expense ratio increased from 14.8% to 15.2% due to expenses of the new intermediaries and the higher IT costs to improve efficiency.

Australian operations won the National Insurance Brokers' General Insurer of the Year award for the fifth consecutive year. This, together with other initiatives designed to ensure QBE has a growing relationship with its distribution channels, has enabled us to maintain high customer retention and pursue new business initiatives. Our IT strategy is focused on removing duplication and manual intervention that exists in our daily dealings with intermediaries.

We have experienced growth in a number of classes of business during 2006 as a result of our initiatives on cross-selling of products. However, we have not written business where premium rates were inadequate, particularly in professional liability products.

We are gradually building our builders' warranty and medical malpractice insurance businesses in Australia. Increased competition and price reductions have meant that we have not met our initial expectations for premium targets for these classes. We are committed to these two new classes of business for QBE but at prices, terms and conditions which mean we can make a reasonable return over the long term.

The excellent results over the past few years and increased competition have resulted in a further slight reduction in overall premium rates for the renewable 1 January 2007 business. We are satisfied that the current market conditions still allow us to meet our profit requirements for each of our products. Going forward we expect the combined operating ratio to deteriorate slightly from the excellent result achieved for 2006 and premium growth to be around 3% without acquisitions.

### AUSTRALIAN OPERATIONS COMBINED OPERATING RATIO

# 82.9%

Compared with **83.6%** last year

### INSURANCE PROFIT RATIO

# 24.7%

Compared with **24.2%** last year

### QBE INSURANCE AUSTRALIA WINS

NIBA General Insurer of the Year for a record fifth year

QBE Group has been recognised for an unprecedented *fifth* consecutive year as General Insurer of the Year at the 2006 National Insurance Brokers of Australia ("NIBA") convention. The award is recognised as Australia's most prestigious in the Australian general insurance industry.



### ACQUISITION

National Credit Insurance (Brokers) Pty Limited

In late December 2005, QBE Group purchased National Credit Insurance (Brokers) Pty Limited ("NCIB"). NCIB distributes trade credit products throughout Australia and New Zealand. The company's success in a highly competitive market is due to its niche focus and targeted product and service propositions.

## Pacific Asia Central Europe

Our Pacific Asia Central Europe ("PACE") division produced a solid underwriting result with a combined operating ratio of 84.4% compared with 82.3% last year and an insurance profit of 20.8% compared with 22.2% last year. The deterioration in the combined operating ratio was mainly due to premium rate reductions and an increase in the frequency of large property claims.

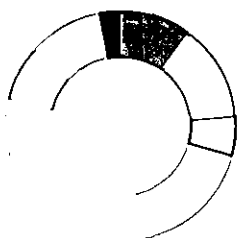
The majority of countries in which we operate produced an underwriting profit and overall claims frequency continues to be low. Strong underwriting profits were achieved in Hong Kong, Hungary, Macau, New Zealand, the Pacific Islands, Singapore, Slovakia, and Ukraine. Small underwriting losses were produced in Denmark, Moldova, the Philippines and Vietnam. Very pleasing results were achieved in all other countries.

Gross written premium increased by 5% to \$727 million and gross earned premium increased 2% to \$704 million. Premium growth was affected by a slight reduction in overall average premium rates and increased competition. Net earned premium increased 5% to \$563 million.

The claims ratio was 42.0% compared with 40.8% last year. The slight deterioration is due to the reduction in premium rates and an increase in large property claims. The commission ratio was 20.4% compared with 18.7% last year, with the increase due to changes in geographic and product mix and slightly higher commissions to retain business. The expense ratio decreased from 22.8% to 22.0% even though we commenced implementation of new IT systems in a number of countries.

PACE business is conducted in 25 countries where we have at least a 50% shareholding, management control and a strong distribution base of over 12,000 agents, and longstanding business relationships with key insurance brokers. Our policy for each of our businesses is to be the master of our own destiny. Our relationships with our joint venture partners in Asia and Central Europe continue to be very strong.

### PORTFOLIO MIX – PACIFIC ASIA CENTRAL EUROPE



#### GROSS EARNED PREMIUM

#### FOR THE YEAR ENDED 31 DECEMBER

	2006	2005
Professional indemnity	10.1%	10.4%
Marine	13.6%	11.1%
Workers' compensation	5.8%	6.0%
Motor and motor casualty	17.3%	18.8%
Property	24.3%	24.8%
Accident and health	7.6%	7.5%
Liability	7.8%	7.5%
Engineering	3.6%	3.2%
Travel	3.7%	3.0%
Householders	3.3%	3.5%
Other	2.9%	4.2%

We continue to focus on higher business retention and building our specialist product lines through intermediaries. We have considered a number of acquisitions but we have been unsuccessful due to the higher prices being paid by competitors. We are investigating other acquisitions but we will only pay prices which meet our acquisition criteria established over a long period of time.

#### SUMMARY

The merger of our PACE and Australian operations to form APACE in early 2005 has been successful with significant synergies already obtained. We have also made better use of our professional skills in a number of products to cross-sell to our clients.

The 2006 result was outstanding with the substantial majority of our operations and products producing strong underwriting profits. We will continue to focus on building our businesses in each of the countries in which we operate, acquisitions that add value and new distribution channels. The 2006 underwriting profit was slightly higher than 2005 and compares very favourably against our peers. It reflects the focus that we have on creating wealth for our shareholders.

The management responsibility for our Central European operations was transferred from PACE to our European operations division with effect from 1 January 2007. Our European operations division has recently extended its activities into a number of new countries and we felt it was time to introduce one approach for Europe and better utilise the substantial product skills that we have based in London. The APACE team has done an excellent job in bringing Central Europe into QBE's culture, with particular emphasis on business acumen. Following the change, the division will be known as Australia Asia Pacific.

#### OUR KEY OBJECTIVES FOR 2007 ARE TO:

- drive closer alignment of our business strategies to those of our key intermediaries;
- complete at least one acquisition in Asia-Pacific;
- continue to improve operational efficiency and eliminate duplication;
- complete the implementation of IT strategies to reduce expenses;
- continue our quality customer focus to increase retention, sales and profitability; and
- further develop the cross-marketing and distribution initiatives across the Australian and Asia-Pacific businesses.

We expect 2007 underwriting profit to continue to be strong but at a slightly higher combined operating ratio than 2006 due to lower premium rates and increased competition.

We have a strong team of insurance professionals and management to ensure that we continue to create wealth for our shareholders. I extend my sincere appreciation to the team in APACE for their loyalty, hard work and contribution during 2006. I also extend my gratitude to our joint venture partners for their support and dedication, as well as our intermediaries for their loyalty and business.

**Vince McLenaghan**

#### PACIFIC ASIA CENTRAL EUROPE COMBINED OPERATING RATIO

**84.4%**

Compared with **82.3%** last year

#### INSURANCE PROFIT RATIO

**20.8%**

Compared with **22.2%** last year

#### RESEARCH INTO THE INDIAN MARKET

The Indian general insurance market presents an exciting opportunity for QBE, growing at more than 20% annually. QBE carried on general insurance business in India for close to 50 years until the sector was nationalised in 1972. The economic and regulatory environment has once more become attractive to foreign companies. After much negotiation and as a first step towards building on this emerging opportunity, QBE was granted regulatory approvals to establish a liaison office in 2006. This is viewed as a major step forward for QBE in India and will help QBE expand its network of business contacts, providing an excellent platform to realise future growth.

# European operations





#### **Atlantic reflections**

QBE's European operations comprise QBE Insurance (Europe) and the Lloyd's division trading as Limit. QBE Insurance (Europe) writes insurance and reinsurance business in the UK and Ireland, and insurance business in mainland Europe. Limit underwrites reinsurance and commercial insurance in the Lloyd's market and is the largest managing agent at Lloyd's.

# European operations

The combined operating ratio for European operations was 85.9% compared with 92.1% last year. The significant improvement in underwriting results is due to a lower level of large catastrophe claims and overall premium rate increases, partly offset by an increase in large individual risk claims. The combined operating ratio also benefited from a continued low frequency of claims on non-catastrophe exposed business.

Gross earned premium increased by 9% to \$5,061 million, primarily due to acquisitions in 2005 and the overall average premium rate increases, particularly for energy and US based property risks. Our new Lloyd's aviation syndicate 5555, supported by an experienced London market team, commenced business in October, with small earned premium for the year. Premium growth has been affected by the weak US dollar and by the decision to significantly reduce our exposures to US and Gulf of Mexico hurricanes compared with 2005. Net earned premium increased 4% to \$3,853 million. Growth was affected by higher reinsurance costs for catastrophe protections and new proportional reinsurance with Equator Re. Net earned premium growth before the proportional reinsurance to Equator Re was 9%.

## KEY RATIOS – EUROPEAN OPERATIONS

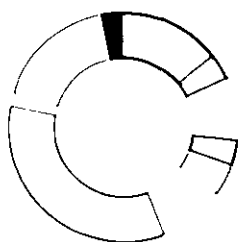
FOR THE YEAR ENDED 31 DECEMBER		QBE INSURANCE (EUROPE)		LIMIT		TOTAL EUROPEAN OPERATIONS	
		2006	2005	2006	2005	2006	2005
Gross written premium	\$M	2,502	2,558	2,711	2,236	5,213	4,794
Gross earned premium	\$M	2,586	2,370	2,475	2,273	5,061	4,643
Net earned premium	\$M	2,209	1,954	1,644	1,743	3,853	3,697
Claims ratio	%	62.2	62.3	49.4	63.6	56.6	62.9
Commission ratio	%	14.5	15.3	20.7	20.3	17.2	17.7
Expense ratio	%	12.1	12.4	12.0	10.6	12.1	11.5
Combined operating ratio	%	88.8	90.0	82.1	94.5	85.9	92.1
Insurance profit to net earned premium	%	19.8	16.8	26.3	12.4	22.6	14.7

## PORTFOLIO MIX – QBE INSURANCE (EUROPE)

### GROSS EARNED PREMIUM

#### FOR THE YEAR ENDED 31 DECEMBER

	2006	2005
Professional indemnity	14.7%	14.2%
Financial and credit	3.4%	2.8%
Marine and aviation	8.8%	4.6%
Accident and health	1.5%	3.3%
Bloodstock	2.3%	2.3%
Property treaty	4.4%	5.5%
Property facultative and direct	9.3%	9.6%
Workers' compensation	11.1%	13.7%
Motor vehicle	22.8%	18.1%
Casualty	1.5%	4.3%
Public and product liability	17.4%	18.8%
Other	2.8%	2.8%



## QBE Insurance (Europe)

QBE Insurance (Europe) writes insurance and reinsurance business in the UK and Ireland, and insurance business in France, Spain, Italy, and Germany. In addition, the results include British Marine which was acquired by the Group in late 2005.

This division produced another strong combined operating ratio of 88.8% compared with 90.0% last year. All major classes of business produced excellent results even though our employers' liability, professional liability and general liability products experienced overall average premium rate reductions and increased competition. We continue to experience a low frequency of claims on the majority of portfolios, particularly on the UK and international (non-US) casualty accounts. Our UK property account traded profitably, but the international property account was affected by two major risk claims.

Gross written premium reduced by 2% to \$2,502 million primarily due to the transfer of a large portion of the reinsurance business to syndicate 566 in Limit and premium rate reductions for most classes of business which more than offset the premium income from acquisitions in 2005. Organic growth was lower than anticipated due to the reduction in premium rates and increased competition for motor, employers' liability, professional liability and general liability business.

The claims ratio slightly reduced to 62.2% compared with 62.3% last year. This reflects the continued low claims frequency during 2006, partly offset by an increase in large individual risk claims.

The commission ratio reduced from 15.3% to 14.5% due to a change in mix of business, primarily the acquisition of British Marine which has a lower commission ratio than the average for QBE Insurance (Europe). The expense ratio decreased from 12.4% to 12.1% reflecting a number of factors, including further synergies from restructures previously announced.

General insurance operations for the division produced a combined operating ratio of 84.6% compared with 83.4% last year. The slight deterioration reflects the impact of lower premium rates and higher large individual risk claims. The UK and international (non-US) casualty portfolios continue to produce excellent results as did some of the more niche accounts such as bloodstock, leisure and sport, crisis management and the asset and product protection portfolios. Our Ensign motor business produced a solid combined operating ratio in a very competitive market. As reported above, the property account was impacted by two major risk claims.

The combined operating ratio from the relatively small inward reinsurance operations was 130.6% compared with 128.7%. The increase is due to an upgrade in the prior year claims provision. A substantial portion of the reinsurance business written in QBE Insurance (Europe) was transferred to Limit at the end of 2005.

QBE Insurance (Europe) business continues to have a large weighting to long tail business. We expect a slight deterioration in the combined operating ratio in 2007 due to the premium rate reductions on these portfolios in 2006 and during the major renewal season on 1 January 2007.

We continue to look for opportunities to expand our UK regional and mainland European businesses using our distribution channels and diverse product skills in our London operations. For 2007, the prospects for growing the mainland European business have been boosted by the transfer back and reintegration of our Central European operations within this division.

### QBE INSURANCE (EUROPE) COMBINED OPERATING RATIO

88.8%

Compared with 90.0% last year

### INSURANCE PROFIT RATIO

19.8%

Compared with 16.8% last year

### SEEING THINGS DIFFERENTLY

In 2006, QBE Insurance (Europe) extended its communications with brokers and other intermediaries, focusing particularly on small to medium sized enterprises in regional centres outside the Greater London area. This successful campaign illustrated examples of the company's innovative and customer focused approach to specialist lines of insurance. The campaign has resulted in increased awareness of QBE as a leading UK insurer across a broader business network and has positively impacted intermediary business.



## Limit

Limit is currently the largest manager and second largest provider of capacity at Lloyd's. QBE provides 100% of capacity for syndicates 566, 2000, 1036 and 5555, and 69% of capacity for syndicate 386. Our Lloyd's capacity for 2007 is £1.1 billion compared with £1.0 billion for 2006. The increase is primarily for our new aviation syndicate 5555.

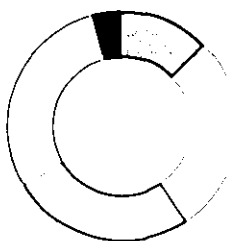
Limit's results for 2006 were excellent with a combined operating ratio of 82.1% compared with 94.5% last year. This significant improvement is due to the lower level of large catastrophes and higher premium rates, principally on US catastrophe-exposed property and energy business. All active syndicates produced excellent results. Claims frequency continued to be low due to the actions taken to improve portfolio performance in recent years and the reduced exposure to attritional losses and US and Gulf of Mexico hurricanes, particularly in syndicates 566, 2000 and 1036.

Gross written premium was up 21% to \$2,711 million and gross earned premium was up 9% to \$2,475 million due to overall average premium rate increases on property and energy business exposed to catastrophes, the transfer of reinsurance business from QBE Insurance (Europe) and a small contribution from the new aviation syndicate which commenced in October. Premium growth was affected by our decision to reduce exposure to US and Gulf of Mexico hurricanes and the appreciation of sterling against the US dollar for the conversion of our substantial US dollar domiciled business. The growth in premium for our casualty business (primarily non-US) was affected by lower premium rates and increased competition. However, customer retention remains high. Net earned premium reduced by 6% to \$1,644 million due to the new proportional reinsurance to Equator Re and increased reinsurance costs to protect catastrophe exposures. Net earned premium growth before the proportional reinsurance to Equator Re was 5%.

The net claims ratio decreased from 63.6% to 49.4%. This substantial improvement is due to the lower net claims from catastrophes, the continued low frequency of claims across the majority of portfolios and positive development of prior year claims.

The commission ratio slightly increased from 20.3% to 20.7% due to the slight change in mix of business. The expense ratio increased from 10.6% to 12.0% due to higher incentives from increased profits, lower profit commissions from external capital providers to syndicate 386 and higher IT costs for the implementation of new systems.

## PORTFOLIO MIX – LIMIT



### GROSS EARNED PREMIUM

#### FOR THE YEAR ENDED 31 DECEMBER

	2006	2005
Professional indemnity	12.9%	13.4%
Marine, energy and aviation	27.7%	17.9%
Property	26.0%	28.7%
Public and products liability	29.3%	29.5%
Other	4.1%	10.5%



The combined operating ratio from general insurance business was 90.5% compared with 93.0% last year. This superb result reflects the continued low frequency of claims on non-catastrophe exposed business. The combined operating ratio for inward reinsurance was an excellent 53.4% compared with 98.2% last year. The substantial reduction is due to the lower net claims from catastrophes, the substantially higher premium rates and a generally lower risk profile.

Our first full year of operation of the new general aviation syndicate 5555, together with our high retention of customers and our lead position for the majority of products which we underwrite, will assist premium growth in 2007.

#### SUMMARY

The significant renewal season of 1 January 2007 saw a slight decrease in overall average premium rates of 3% as a result of the continued low frequency of claims and increased competition, although this varied markedly by class of business. We have a lead position in the London market and we are looking for opportunities to build our business using our substantial London market expertise for specialist products in regional UK and mainland European markets. Our 2007 exposure to major catastrophes is largely unchanged from 2006. We have been able to restructure some of our reinsurance programmes to enable a slight overall reduction in the cost of reinsurance in 2007 whilst also enhancing the quality and security of the protections provided.

We are satisfied with our decision in 2006 to significantly reduce our exposures to improve the reward for our shareholders over the long term. We will not be tempted by the relatively low level of catastrophes in 2006 to write more premium volume and increase our exposures to windstorms and other catastrophes.

We continue to look for opportunities to further diversify our products in our mainland European business. The Central European operations which were part of QBE's APACE division in 2005 and 2006 have been transferred to European operations with effect from 1 January 2007 to enable us to maximise our geographic and product spread. After the transfer we will have operations in 12 countries across mainland Europe.

We continue to maintain a conservative approach to reinsurance purchasing and retentions for large losses and catastrophes. This, together with our philosophy of cautious reserving of prior year exposures and substantial allowances in unearned premium for large losses and catastrophes, gives us confidence regarding our performance in 2007.

#### OUR KEY OBJECTIVES FOR 2007 ARE TO:

- continue to seek acquisition opportunities that meet QBE's criteria and fit our strategic priority to further enhance our product mix and geographic spread;
- successfully reintegrate the Central European countries with our other mainland European operations to deliver profitable growth;
- continue to deploy our specialist products to a wider client base and to refine our underwriting delivery through more diverse distribution channels;
- focus on protecting our underwriting margins in the anticipated competitive market conditions that will prevail throughout 2007; and
- continue to seek further operational and process synergies to achieve cost reductions, particularly through our medium term strategy to reduce our multiplicity of IT platforms.

2006 was an exceptional year in terms of profitability for our European operations. The most pleasing aspect is that the substantial majority of our portfolios produced improved returns for our shareholders. The now expanded European operations provides us with new opportunities and challenges to build on our many products and strong portfolio management capabilities.

I appreciate the dedication, hard work and support of my team. I particularly thank them for the significant contribution that they have made to the very strong 2006 result.

**Steven Burns**

#### LIMIT COMBINED OPERATING RATIO

**82.1%**

Compared with **94.5%** last year

#### INSURANCE PROFIT RATIO

**26.3%**

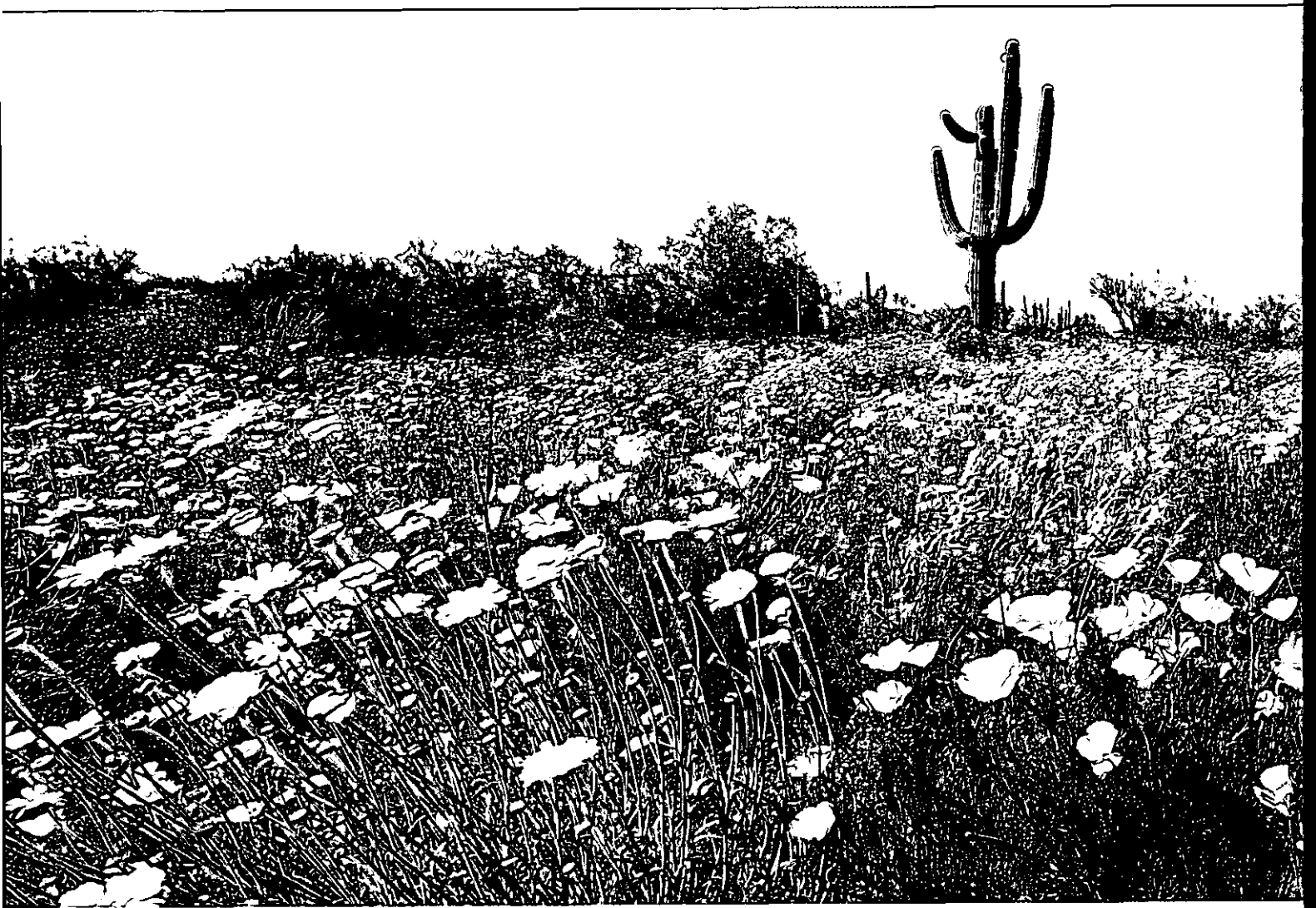
Compared with **12.4%** last year

#### THE LAUNCH OF A NEW SYNDICATE

Launched on 1 October 2006, syndicate 5555 is QBE's new dedicated, specialist aviation syndicate. The creation of syndicate 5555 represents a major step forward in all aspects of QBE's involvement in the specialist aerospace sector and builds upon some 40 years of experience in Australia and syndicate 566's aviation reinsurance book. The new syndicate, which is based in London and forms part of our Limit operations, will write a book of business across three main sectors:

- Airlines - commercial jet operators with upwards of 50 passengers per aircraft
- General aviation - all classes of aircraft, helicopters and airships up to a maximum of 50 seats
- Products - airports and third party service providers

# the Americas





**Desert bloom,** Nevada, United States

With headquarters in New York, QBE the Americas writes general insurance and *reinsurance* business in the US, Central and South America and Bermuda.

# the Americas

QBE the Americas is comprised of four main streams of insurance and reinsurance business. The specialist insurance programme business focuses on niche products and markets through managing agents. Our general insurance business comprises regional brands that focus on small to medium clients throughout the Americas to distribute insurance products through independent and in-house agents. The Latin America division comprises general insurance operations in Argentina, Brazil and Colombia and reinsurance businesses through our joint venture QBE Del Istmo in Colombia, Mexico, Panama and Peru. Finally, the fourth stream is our reinsurance business, supporting predominantly small to medium insurers with limited exposure to major catastrophes.

QBE's operations in the Americas produced a record underwriting profit with a combined operating ratio of 89.7% compared with 92.9% last year. The improvement was partly due to higher overall average premium rates and a slightly lower level of catastrophes. There were a number of small tornado and hail catastrophe losses in 2006.

Gross written premium increased 30% to \$1,941 million and gross earned premium increased 31% to \$1,876 million. This substantial increase was due to acquisitions made in 2005 and 2006, higher overall average increases in premium rates and a continued high retention of business. Net earned premium increased 37% to \$1,153 million. The substantial difference between gross and net earned premium is due to proportional reinsurance ceded to highly rated reinsurers for our specialist programme business. Of the total reinsurance cost of \$723 million, 69% related to proportional reinsurance. Equator Re participates on a number of these proportional reinsurance programmes.

The net claims ratio was 55.9% compared with 60.0% last year. Our continued low frequency of claims and our very low exposure to long tail casualty business has been beneficial. The commission ratio was 25.6% compared with 25.5% last year with the small increase mainly due to lower profit commissions from proportional reinsurance protections. The expense ratio increased from 7.4%

to 8.2%, primarily from the higher expense ratio on growth in general insurance business, increased staff incentives from improved profitability and the cost of new IT.

General insurance business for 2006 was 77% of total gross written premium compared with 72% last year. This reflects our strategy of focusing on general insurance business. The combined operating ratio from our general insurance business was 91.1% compared with 92.5% last year. Our reinsurance business, which is primarily US regional and Latin American business, produced a combined operating ratio of 86.7% compared with 93.5% last year.

The majority of products produced excellent underwriting results as did the acquisitions made in 2005 and 2006. We continue to focus on selected regional portfolios in the US to ensure that we are not as exposed to major catastrophes as others who write nationwide accounts and large risks.

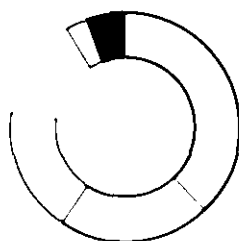
The last few months of 2006 have been very productive in our acquisition activity. We have been fortunate to be able to make two large acquisitions in late December 2006 and early January 2007 respectively which not only meet QBE's acquisition criteria but also provide further product diversification and increased distribution in the US. These acquisitions are subject to regulatory approval.

The acquisition of Praetorian Financial Group will more than double the size of our specialist insurance programme business written through managing agents. QBE has an excellent record of profitability in this type of business. The Praetorian Financial Group was reactivated in 2005 to carefully select profitable specialist insurance programmes from the over 250 written by the Clarendon Insurance Group, a wholly owned subsidiary of Hannover Re. The integration of Praetorian Financial Group's business into QBE, utilising QBE's management approach, will mean that our US operations will have close to \$3.1 billion of annualised specialist insurance programme gross written premium.

## KEY RATIOS – THE AMERICAS

FOR THE YEAR ENDED 31 DECEMBER		2006	2005
Gross written premium	\$M	1,941	1,492
Gross earned premium	\$M	1,876	1,435
Net earned premium	\$M	1,153	843
Claims ratio	%	55.9	60.0
Commission ratio	%	25.6	25.5
Expense ratio	%	8.2	7.4
Combined operating ratio	%	89.7	92.9
Insurance profit	%	13.9	10.3

## PORTFOLIO MIX – THE AMERICAS



GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER		2006	2005
Property		38.1%	37.4%
Casualty		21.6%	25.0%
Motor and motor casualty		17.7%	13.3%
Accident and health		14.0%	15.5%
Workers' compensation		3.1%	2.8%
Other		5.5%	6.0%

The acquisition of Winterthur US complements the acquisitions of National Farmers Union in late 2005 and the OneBeacon agriculture business in 2006, with general insurance business written through independent and in-house agents. Winterthur US writes business mainly through two well known brand names, General Casualty and Unigard. This acquisition will add 1,700 independent agents in 33 states of the US focusing on small to medium sized client business. The Winterthur US business provides QBE with excellent infrastructure, including IT to grow the general insurance business through the independent agency stream in the US. The acquisition will increase our annualised general insurance gross written premium to close to \$2.2 billion.

Managing agents are full service agents for specific products using appropriate delegated authorities, generating higher commissions and low expense ratios. Independent agents are generally sales agents selling products on behalf of a number of insurers.

In addition to the above, the Americas' final two streams of business comprise our reinsurance operation, which is predominantly regional US business of approximately \$0.4 billion, and our Latin America business of \$0.2 billion. Our focus for the next two years will be on integrating the recent acquisitions in the US, the achievement of \$50 million of synergies after tax and on building our Latin America business. The recent acquisition of Seguros Cumbre SA de CV in Mexico will provide us with an ideal base for commencement of general insurance operations in Mexico. It has a profitable commercial lines portfolio of small to medium sized clients with an expected annualised gross written premium of \$60 million.

The acquisitions mean that gross written premium is expected to grow by more than 150% in 2007 and a further 20% in 2008. As the Praetorian Financial Group and Winterthur US acquisitions have a relatively low exposure to major catastrophes, the cost of our excess of loss reinsurance protections will substantially reduce as a percentage of premium to around 6% compared with 9% in 2006.

We expect additional profits after tax from our new acquisitions of \$380 million in the first full year of operation before synergies and after the cost of funding. Longer term, we aim to exceed this using our disciplined approach to portfolio management, our continued focus on return on capital allocated to the Americas and our dedicated management of the products that we underwrite.

In 2008, QBE the Americas will be close to 40% of the Group's gross written premium as a result of the acquisitions. Our team is aware of the need to maximise the opportunities from our existing excellent businesses and the new acquisitions. We remain committed to pricing adequacy, underwriting integrity, sound agency management and a counter-cyclical approach to insurance and reinsurance on property, casualty and health business using our admitted and non-admitted licences. Our strategy of regular review of each portfolio to improve performance and product and geographic diversification has worked well for us.

#### OUR KEY OBJECTIVES FOR 2007 ARE:

- integration of the Praetorian Financial Group and Winterthur US portfolios and operations and the achievement of profit targets and synergies;
- continued focus on gradually expanding our presence in key Latin American markets and integration of Seguros Cumbre in Mexico;
- to maintain discipline on pricing; and
- to maintain high retention of our quality customers.

The board and management of QBE Group have given management of QBE the Americas enormous support with the three acquisitions in recent months. Our objective is to deliver the targeted returns and more.

I express my sincere appreciation for the enormous support and dedication that I have received from our team over the past 12 months, particularly their contribution to the strong insurance profit for 2006 and their assistance on our recent acquisition activity.

**Tim Kenny**

#### THE AMERICAS COMBINED OPERATING RATIO

**89.7%**

Compared with **92.9%** last year

#### INSURANCE PROFIT RATIO

**13.9%**

Compared with **10.3%** last year

#### QBE THE AMERICAS – AGRI BUSINESS DIVISION

In September 2006, QBE the Americas continued its strategy of focused diversification with the completion of the previously announced acquisition of OneBeacon Insurance Company's Agri business division.

From its Kansas offices, the new QBE Agri division writes farm and ranch, commercial agricultural and companion lines throughout the US with a concentration in 12 core states. QBE the Americas is proud to welcome the division's employees and management as members of its specialist insurance team and will continue to support the division's trusted relationships with its longstanding independent agent network.

QBE Agri anticipates it will write over \$115 million in premium in 2007. Coupled with the acquisition of National Farmers Union Insurance Company in 2005 and the acquisition of Winterthur US, QBE will be one of the leading agricultural insurers in the US. QBE's agricultural based business will now exceed \$380 million in premium.

# Investments



**Mark ten Hove**

Group general manager, investments

Investment income for 2006 was ahead of budget and our overall internal benchmarks. This outperformance was due to interest rates being slightly higher than anticipated, a continuation of strong equity markets and our decision to be short duration on cash and fixed interest securities. The results for the year were achieved on a low risk investment strategy with targets based on achieving absolute returns. We have now outperformed the absolute return targets in seven out of the past eight years since these targets were introduced.

We significantly outperformed external benchmarks on cash and fixed interest securities for our major portfolios in the UK, US, Australian and Euro markets. Our short duration strategy has consistently worked for us during the recent period of rising interest rates. We underperformed equity markets, primarily because of our absolute return focus including the locking in of equity gains for 2006 in October. The equity derivatives were unwound in early January 2007.

Gross investment income was \$985 million compared with \$843 million last year. The Group's gross investment yield on cash and fixed interest securities increased from 4.3% to 4.7% and the overall gross yield including equities was unchanged at 5.2%. The yield on cash and fixed interest securities includes unrealised gains and losses to bring investments to market value. Net investment income including borrowing costs and investment expenses increased from \$718 million to \$822 million. The gross and net investment income includes realised and unrealised gains on equities of \$104 million before tax compared with gains of \$130 million before tax last year.

At 31 December 2006 we held listed equities at 8.6% of total investments and cash. Our equity portfolio was invested 46% in Australia, 27% in the UK, 15% in the US and 12% in portfolios in other countries. Our cash and fixed interest portfolios had an average maturity of 0.4 years which we have subsequently lengthened to around 0.7 years in January 2007. We will increase the duration as soon as we believe the interest rate cycles have reached their peak. The strong cash flow and acquisitions in 2006 have resulted in a 14% increase in investments and cash from \$17.6 billion at 31 December 2005 to \$20.0 billion at 31 December 2006.

We continue to maintain a policy of matching liabilities with assets of the same currency so far as practicable and matching all "tradeable" overseas

## INVESTMENT INCOME

### FOR THE YEAR ENDED 31 DECEMBER

	2006 \$M	2005 \$M
Dividends	47	41
Interest	719	567
Realised (losses) gains on sale of controlled entities	(1)	11
Other income	7	8
	<b>772</b>	<b>627</b>
Realised gains on fixed interest securities	60	61
Realised (losses) gains on equities and investment properties	(13)	94
Unrealised gains on fixed interest securities	43	26
Unrealised gains on equities and investment properties	123	35
Gross investment income	<b>985</b>	<b>843</b>
Exchange gains	18	3
Interest expense	(128)	(96)
Other expenses	(32)	(15)
Net cost of ABCs	(21)	(17)
Net investment income	<b>822</b>	<b>718</b>

shareholders' funds back into Australian dollars. The nature of our business is such that we will have slight mismatches from time to time.

The recent acquisitions in the US together with anticipated cash flow will bring investments and cash to close to \$28 billion by the end of 2007. This, together with the recent interest rate increases in Australia, the US, Euro markets and the UK will be beneficial for investment income in 2007. We will continue our low risk absolute return strategy. For 2007, this means a relatively short duration fixed income portfolio and for equities, which are held mainly to support our shareholders' funds, maintaining a portfolio slightly less than 10% of total investments and cash.

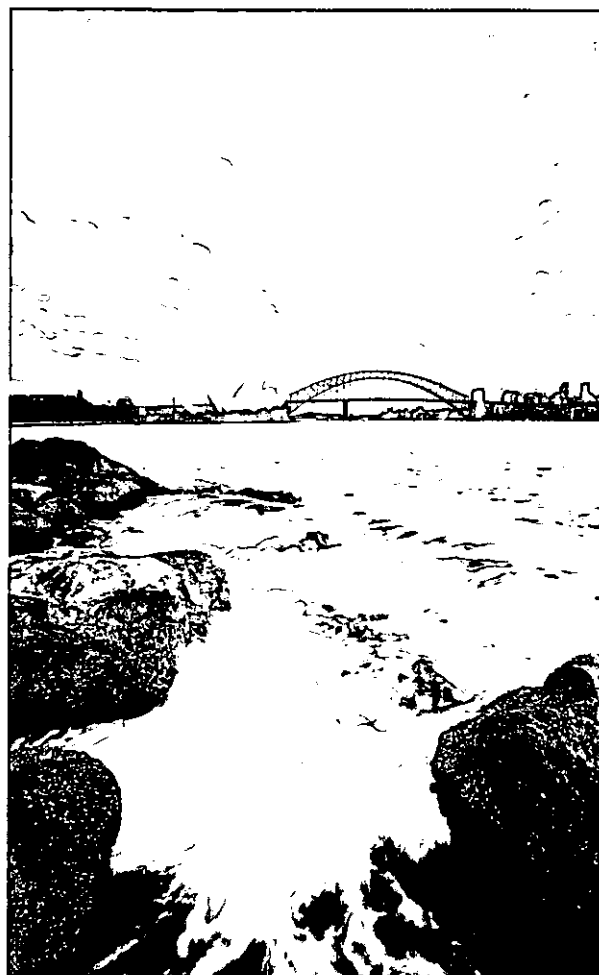
We expect interest rates to remain relatively unchanged in the US, Australia and the UK, and recent indications suggest that some equity markets will continue to rise albeit at a considerably lower rate than the past three years. Our comprehensive investment model, which enables us to review the implications of numerous investment scenarios and asset allocations, continues to be a valuable tool for actively managing our investment portfolio and monitoring our absolute return strategy.

#### OUR KEY OBJECTIVES FOR 2007 ARE TO:

- achieve or outperform our absolute return targets for 2007;
- integrate the new portfolios from the US acquisitions;
- upgrade funds management and treasury systems;
- continue to invest in our people; and
- reduce funds management costs as a percentage of funds under management to competitive levels.

The investment team is very pleased with its outperformance of our financial targets and internal benchmarks for 2006. I would like to take this opportunity to thank my team for their contribution and hard work during the past year.

**Mark ten Hove**



Harbour seascape, Sydney, Australia

## TOTAL INVESTMENTS AND CASH

AS AT	31 DECEMBER 2006		31 DECEMBER 2005	
	\$M	%	\$M	%
Cash	1,019	5.1	1,061	6.0
Short term money	10,040	50.3	8,292	47.1
Fixed interest securities and other	7,134	35.7	7,537	42.9
Equities	1,741	8.7	674	3.8
Investment properties	38	0.2	33	0.2
Total investments and cash	19,972	100.0	17,597	100.0

## CURRENCY MIX

MARKET VALUE OF EQUITIES	2006 %	2005 %	MARKET VALUE OF TOTAL INVESTMENTS AND CASH	2006 %	2005 %
Australian dollar	46	54	Australian dollar	28	30
Sterling	27	37	Sterling	35	34
US dollar	15	2	US dollar	24	23
Other	12	7	Other	13	13

# Board of directors



- |   |   |   |
|---|---|---|
| 1 | 2 | 3 |
| 4 | 5 | 6 |
| 7 | 8 | 9 |
- 1 Duncan Boyle
  - 2 John Cloney
  - 3 Frank O'Halloran
  - 4 Isabel Hudson
  - 5 Len Bleasel AM
  - 6 Irene Lee
  - 7 The Hon Nick Greiner AC
  - 8 Belinda Hutchinson
  - 9 Charles Irby



#### DUNCAN BOYLE

BA, FCII, AGE 55

Mr Boyle was appointed an independent non-executive director of QBE in September 2006. He is a member of the audit and remuneration committees. Mr Boyle has 34 years of insurance experience working in Australia, New Zealand and the UK.

#### JOHN CLONEY

ANZIF, FAIM, FAICD, AGE 66  
CHAIRMAN

Mr Cloney joined QBE as managing director in 1981. He retired in January 1998, at which time he became a non-executive director. He was appointed deputy chairman in April 1998 and chairman in October 1998. He is chairman of the chairman's and funding committees, and a member of the investment and remuneration committees. Mr Cloney is a director of ABN AMRO Australia Holdings Pty Limited, Boral Limited and Maple-Brown Abbott Limited. He is chairman of the Create Foundation and a trustee of the Sydney Cricket & Sports Ground Trust.

#### FRANK O'HALLORAN

FCA, AGE 60  
CHIEF EXECUTIVE OFFICER

Mr O'Halloran was appointed chief executive officer in January 1998 and is a member of the chairman's, funding and investment committees. He joined QBE in 1976 as Group financial controller. He was appointed chief financial officer in 1982, joined the board as director of finance from 1987 to 1994 and was director of operations from 1994 to 1997. He has had extensive experience in professional accountancy for 14 years and insurance management for over 30 years.

#### ISABEL HUDSON

MA, FCII, AGE 47

Ms Hudson is based in the UK and was appointed an independent non-executive director of QBE in November 2005. She is a member of the audit and remuneration committees. Ms Hudson is chief executive of Synesis Life Limited. She is a member of the committee of Scope, a UK charity.

#### LEN BLEASEL AM

FAIM, FAICD, AGE 64

Mr Bleasel was appointed an independent non-executive director of QBE in January 2001. He is chairman of the remuneration committee and a member of the audit committee. Mr Bleasel is chairman of ABN AMRO Australia Holdings Pty Limited. He is also chairman of the Zoological Parks Board of NSW and is on the advisory boards of various charities.

#### IRENE LEE

BA, BARRISTER-AT-LAW, AGE 53

Ms Lee was appointed an independent non-executive director of QBE in May 2002. She is chairman of the audit committee and a member of the funding and investment committees. Ms Lee is executive chairman of Mariner Bridge Investments Limited and is a director of Ten Network Holdings Limited and ING Bank (Australia) Limited. She is a member of the Takeovers Panel, the advisory council of JP Morgan Australia and the executive council of the UTS Faculty of Business. Ms Lee is also a trustee of the Art Gallery of New South Wales.

#### THE HON NICK GREINER AC

BEC, MBA, AGE 59

Mr Greiner was appointed an independent non-executive director of QBE in September 1992. He is a member of the audit, chairman's, funding and remuneration committees. He is chairman of Bradken Limited and Bilfinger Berger Australia, and deputy chairman of Stockland Trust Group. He is a director of BlueFreeway Limited and McGuigan Simeon Wines Limited. He is a trustee of the Sydney Theatre Company and a governor of the Committee of Economic Development of Australia.

#### BELINDA HUTCHINSON

BEC, FCA, AGE 53

Ms Hutchinson was appointed an independent non-executive director of QBE in September 1997. She is chairman of the investment committee and a member of the audit and funding committees. She is a director of Coles Group Ltd, St Vincent's & Mater Health Sydney Limited and Telstra Corporation Limited.

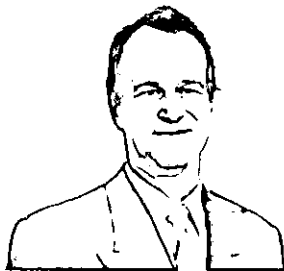
#### CHARLES IRBY

FCA (ENGLAND & WALES), AGE 61

Mr Irby is based in the UK and was appointed an independent non-executive director of QBE in June 2001. He is a member of the investment committee and chairman of the European operations' audit committee. He is chairman of Aberdeen Asset Management plc and a director of Great Portland Estates plc and North Atlantic Smaller Companies Investment Trust plc. Mr Irby is also a trustee and governor of King Edward VII's Hospital Sister Agnes.

# Corporate governance statement

This statement aims to disclose as clearly and objectively as possible QBE's corporate governance standards and practices so that they can be readily understood by our shareholders, policyholders and other stakeholders. QBE also continues to focus on other equally important issues such as the strength of its outstanding claims provision, the quality of its reinsurers and the depth of its culture of honesty, integrity and business acumen.



**Duncan Ramsay**  
General counsel and company secretary

## BOARD OF DIRECTORS

Directors are selected to achieve a broad range of skills, experience and expertise complementary to the Group's activities. These details for individual directors are included on page 45 and can also be found on the QBE website. The board comprises nine directors being the chairman, the chief executive officer and seven independent non-executive directors using the "independence" definition of the ASX Corporate Governance Council. Applying this definition, the board has determined that a non-executive director's relationship with QBE as a professional adviser, consultant, supplier, customer or otherwise is not material unless amounts paid under that relationship exceed one per cent of the Group's revenue or expenses.

The roles of chairman and chief executive are not exercised by the same individual.

As a general guide, the board has agreed that a non-executive director's term should be approximately 10 years. The board considers that a mandatory limit on tenure would deprive the Group of valuable and relevant corporate experience in the complex world of international general insurance and reinsurance. The Hon NF Greiner AC has been a non-executive director for more than 10 years, and he will retire at the 2007 AGM in April.

The chairman has 50 years involvement in the insurance industry, including over 17 years as managing director of QBE until he retired in January 1998. He became chairman in October 1998. The chairman's former executive capacity with QBE has been fully disclosed to shareholders, who re-elected him as a director by an overwhelming majority at the 2006 AGM. QBE's other directors consider that the chairman exercises independent judgment. Further, they believe it is in shareholders' and policyholders' interests to retain his wealth of experience and have resolved that he should continue in that role. However, the chairman is not considered to be an "independent" director as recommended by the ASX Corporate Governance Council because there was less than a three year period between him acting as managing director and being appointed chairman.

The chairman oversees the performance of the board, its committees and each director. The board review procedure involves a periodic assessment of the entire board, with the review of each director comprising a combination of written questions and answers covering the areas concerned together with an interview with each director. The chairman reports the overall result to the board as a whole and it is discussed by all directors. This review procedure is a precursor to other directors determining whether to support, via the notice of meeting, a non-executive director for re-election at an AGM.

QBE's constitution provides that no director except the chief executive officer shall hold office for a continuous period in excess of three years or past the third annual general meeting following a director's appointment, whichever is the longer, without submission for re-election at the next AGM. Under QBE's constitution, there is no maximum fixed term or retirement age for non-executive directors.

Directors advise the board on an ongoing basis of any interest they have that they believe could conflict with QBE's interests. If a potential conflict does arise, either the director concerned may choose not to, or the board may decide that he or she should not, receive documents or take part in board discussions whilst the matter is being considered.

Under QBE's constitution, management of the Group is vested in the board. In particular, the board:

- oversees corporate governance;
- selects and supervises the chief executive officer;
- provides direction to management;
- approves the strategies and major policies of the Group;
- monitors the achievement of strategies and policies;
- monitors performance against plan;
- considers regulatory compliance; and
- reviews human resources (including succession planning), information technology and other resources.

The board ensures it has the information it requires to be effective including, where necessary, external professional advice. A non-executive director may seek such advice at the company's cost with the consent of the chairman. All directors would receive a copy of such advice. Non-executive directors may attend relevant external training courses at QBE's cost with the consent of the chairman.

Strategic issues and management's detailed budgets and three year business plans are reviewed at least annually by the board. The board receives updated forecasts during the year. Visits by non-executive directors to the Group's offices in key locations are encouraged. To help the board to maintain its understanding of the business and to effectively assess management, directors have regular presentations by the divisional chief executive officers and other senior managers of the various divisions on topics including budgets, three year business plans and operating performance, and have contact with senior employees at numerous times and in various forums during the year. The board meets regularly in Australia and at least once a year overseas. Each meeting normally considers reports from the chief executive officer and chief financial officer together with other relevant reports. The board regularly meets in the absence of management. The chairman and chief executive officer in particular, and board members in general, have substantial contact outside board and committee meetings.

## COMMITTEES

The board is supported by several committees which meet regularly to consider the audit process, investments, remuneration and other matters. The main committees of the board are the audit committee, the investment committee and the remuneration committee. These committees operate under a written charter approved by the board. Any non-executive director may attend a committee meeting. The committees have direct and unlimited access to QBE's senior managers during their meetings and may consult external advisers when necessary at QBE's cost, including requiring their attendance at committee meetings. Committee membership is reviewed regularly.

In addition, the board has established a chairman's committee, comprising the chairman, a non-executive director, currently The Hon NF Greiner AC, and the chief executive officer, and a funding committee, comprising the chairman, The Hon NF Greiner AC, Ms BJ Hutchinson, Ms IYL Lee and the chief executive officer. These committees meet as required, including to deal with such matters as are referred by the board from time to time.

The board regularly discusses its composition and is involved in the selection of new members. All directors are members of the nomination committee. External consultants may be engaged where necessary to search for prospective board members. The board has adopted non-executive director nomination guidelines. As a relatively small board of nine directors (including the chief executive officer), the directors believe that this is an efficient mechanism for dealing with this issue.

Details of directors' attendance at board and committee meetings are outlined in the table of meeting attendance set out in the directors' report on page 55. A report on each committee's last meeting is provided to the next board meeting. The company secretary acts as secretary to all committees.

### Audit committee

The membership of the audit committee may only comprise non-executive directors. The audit committee normally meets four times a year. The chairman must be a non-executive director who is not the chairman of the board. The current members are Ms IYL Lee (chairman), Mr LF Bleasel AM, Mr DM Boyle, The Hon NF Greiner AC, Ms IF Hudson and Ms BJ Hutchinson.

The role of the audit committee is to oversee the integrity of QBE's financial reporting process. This includes review of:

- the quality of financial reporting to the Australian Securities and Investments Commission ("ASIC"), ASX and shareholders;
- the consolidated entity's accounting policies, practices and disclosures; and
- the scope and outcome of external and internal audits.

The audit committee's responsibilities include the financial statements (including items such as the outstanding claims provision, reinsurance recoveries and income tax), external and internal audit, risk management, internal controls, compliance other than regulatory compliance and significant changes in accounting policies.

The chairman of the board and other non-executive directors normally attend audit committee meetings which consider the 30 June and 31 December financial reports. Meetings of the audit committee normally include, by invitation, the chief executive officer, the chief financial officer, the chief operating officer, the chief actuarial officer, the chief risk officer, the Group internal audit manager and the external auditor. On occasion, other relevant senior managers also attend.

The audit committee has direct and unlimited access to the external auditor. The external auditor, the Group internal audit manager and the chief actuarial officer have direct and unlimited access to the audit committee.

The chief executive officer and chief financial officer provide the board with certificates in relation to the financial reports and risk management as recommended by the ASX Corporate Governance Council and as required by the *Corporations Act 2001*.

#### External auditor independence

QBE firmly believes that the external auditor must be, and must be seen to be, independent. The external auditor confirms its independence in relation to the 30 June and 31 December financial reports and the audit committee confirms this by separate enquiry. The audit committee has contact with the external auditor in the absence of management in relation to the 30 June and 31 December financial reports and otherwise as required. The external auditor normally confers with the audit committee in the absence of management as part of each meeting.

QBE has issued an internal guideline on external auditor independence. Under this guideline, the external auditor is not allowed to provide the excluded services of preparing accounting records, financial reports or asset or liability valuations. Furthermore, it cannot act in a management capacity, as a custodian of assets or as share registrar.

The board believes some non-audit services are appropriate given the external auditor's knowledge of the Group. QBE may engage the external auditor for non-audit services other than excluded services subject to the general principle that fees for non-audit services should not exceed 30% of all fees paid to the external auditor in any one financial year. External tax services are generally provided by an accounting firm other than the external auditor.

The external auditor has been QBE's auditor for many years. As a diverse international group, QBE requires the services of one of a limited number of international accounting firms to act as auditor. It is the practice of QBE to review from time to time the role of the external auditor. The *Corporations Act 2001*, Australian professional auditing standards and the external auditor's own policy deal with rotation and require rotation of the lead engagement partner after five years. In accordance with such policy, the lead engagement partner of the external auditor rotated in 2004.

#### Investment committee

The membership of the investment committee comprises four non-executive directors and one executive director. The investment committee normally meets three times a year. The chairman must be a non-executive director who is not the chairman of the board. The current members are Ms BJ Hutchinson (chairman), Mr EJ Cloney, Mr CLA Irby, Ms IYL Lee and Mr FM O'Halloran. Meetings of the investment committee normally include, by invitation, the Group general manager, investments, the chief financial officer and the chief operating officer.

The role of the investment committee is to oversee QBE's investment activities. This includes review of:

- investment objectives and strategy;
- investment risk management;
- currency, equity and fixed interest exposure limits;
- credit exposure limits with financial counterparties; and
- Group treasury.

The investment committee's responsibilities include review of economic and investment conditions as they relate to QBE, approval of

management's recommended investment strategy and review of investment performance, including the performance of QBE's defined benefit superannuation funds.

#### Remuneration committee

The membership of the remuneration committee may only comprise non-executive directors. The remuneration committee normally meets four times a year. The chairman must be a non-executive director who is not the chairman of the board. The current members are Mr LF Bleasel AM (chairman), Mr DM Boyle, Mr EJ Cloney, The Hon NF Greiner AC and Ms IF Hudson. Meetings of the remuneration committee normally include, by invitation, the chief executive officer, the chief operating officer and the Group general manager, human resources.

The role of the remuneration committee is to oversee QBE's general remuneration practices. The remuneration committee's responsibilities include:

- recommendation of the total remuneration cost ("TRC") of the chief executive officer and approval of the TRC of the Group operations executive and Group head office management;
- review and approval of short and long term incentives such as equity based plans;
- review of superannuation;
- review of performance measurement criteria, succession plans and other major human resource practices;
- review of personal development plans for the Group executive and other senior positions; and
- recommendations on non-executive director remuneration.

QBE has operations and staff in 44 countries with differing laws and customs. QBE's remuneration policy therefore needs to reflect the fact that QBE is a global organisation, whilst also taking into account local remuneration levels and practices.

#### Details of remuneration

Details of remuneration of employees and non-executive directors, including employee entitlements under the Employee Share and Option Plan and the Deferred Compensation Plan, are included in the remuneration report on pages 57 to 67 and in notes 27 and 28 to the financial statements.

## RISK MANAGEMENT

QBE's core business is the underwriting of risk. The Group's successful performance over many years clearly establishes its substantial risk management credentials.

Diversification is used as a tool to reduce the Group's overall insurance risk profile by spreading exposures, thereby reducing the volatility of results. QBE's approach is to diversify insurance risk, both by product and geographically. Product diversification is achieved through a strategy of developing strong underwriting skills in a wide variety of classes of business. A combination of core and specialty products under the control of proven employees skilled in such products allows QBE to lead underwrite in many of the markets in which we operate. Geographic diversification is achieved by operating in 44 countries.

QBE has a global risk management framework that defines the risks that QBE is in business to accept and those that we are not, together with the key risks that QBE needs to manage and the framework and standards of control that are needed to manage those risks.

The foundation of our risk management is the obligation and desire to manage our future and create wealth for our shareholders by maximising profitable opportunities through:

- adequate pricing of risk;
- avoiding unwelcome surprises by reducing uncertainty and volatility, such as by controlling aggregate exposures and maintaining sound reinsurance arrangements;
- optimising risk and more effectively allocating capital and resources by assessing the balance of risk and reward;
- achieving competitive advantage through better understanding of the risk environment in which we operate;
- complying with laws and internal procedures; and
- improving resilience to external events.

The Group has established internal controls to manage risk in the key areas of exposure relevant to its business. The broad risk categories are insurance risk, acquisition risk, operational risk and funds management and treasury risk. Internal controls and systems are designed to provide reasonable assurance that the assets of the Group are safeguarded, insurance and investment exposures are within desired limits, reinsurance protections are adequate, counterparties are subject to security assessment and foreign exchange exposures are within predetermined guidelines. The board approves annually a comprehensive risk management strategy ("RMS") and reinsurance management strategy ("REMS"), both of which are lodged with the Australian Prudential Regulation Authority ("APRA"). The RMS deals with all areas of significant business risk to the Group. The REMS covers topics such as the Group's risk tolerance and the Group's strategy in respect of the selection, approval and monitoring of all reinsurance arrangements. The Group security committee assesses reinsurer counterparty security. This management committee normally meets four times a year and holds special meetings as required.

While the RMS and REMS are approved by the board, QBE believes that managing risk is the responsibility of the Group head office and the business units, and that all staff need to understand and actively manage risk. The business units are supported by compliance teams and by Group senior management. Further information is provided on pages 18 and 19 of the annual report and in notes 4 and 5 to the financial statements.

#### Internal audit

A global internal audit function is critical to the risk management process. QBE's internal audit function reports to senior management and the audit committee on the monitoring of the Group's worldwide operations. Internal audit provides independent assurance that the design and operation of the controls across the Group are effective. The internal audit function operates under a written charter from the audit committee. Other governing documents include a reporting protocol, internal audit manual, internal audit rating

system, internal audit opinion levels and internal audit timetables. A risk based internal audit approach is used so that higher risk activities are reviewed more frequently. The Group's internal audit teams work together with the external auditor to provide a wide audit scope.

#### Delegated authorities

QBE has operated under an extensive written system of delegated authorities for many years. In particular, a written delegated authority with specified limits is approved by the board each year to enable the chief executive officer to conduct the Group's business in accordance with detailed budgets and business plans. This authority deals with topics such as underwriting, reinsurance protection, claims, investments, acquisitions and expenses. The chief executive officer delegates his authority to management throughout the Group on a selective basis taking into account expertise and past performance. Compliance with delegated authorities is closely monitored by management and adjusted as required for actual performance, market conditions and otherwise. Management and the Group's internal audit teams review compliance with delegated authorities and any breach can lead to disciplinary procedures, including dismissal in serious cases.

#### Actuarial review

It is a longstanding practice of the directors to ensure that most of the Group's insurance liabilities are assessed by actuaries. The Group's outstanding claims provision is reviewed by experienced internal actuarial staff. The chief actuarial officer is based in head office and there are over 90 actuarial staff who are involved in forming an independent view, separate from management, of the central estimate and the probability of adequacy of the outstanding claims provision and premium liabilities, premium rates and related matters. Approximately 90% of QBE's outstanding claims provision is also reviewed by external actuaries at least annually. Most external actuaries are from organisations which are not associated with the external auditor.

#### Insurance and other regulation

General insurance and, to a lesser extent, reinsurance are heavily regulated industries. In addition to the Group's accounting, legal, tax and other professional teams, each division has compliance personnel and there is a Group risk and compliance manager based in head office. In Australia, regulators include ASIC, the Australian Competition and Consumer Commission, APRA, the Australian Privacy Commissioner and relevant state authorities for compulsory third party motor insurance and workers' compensation insurance. These regulatory bodies enforce laws which deal with a range of issues, including capital requirements and consumer protection. Similar local laws and regulations apply to the Group's operations outside Australia.

### COMMUNICATION AND GUIDELINES

#### Continuous disclosure

ASX Listing Rule 3.1 requires QBE to inform the ASX immediately once QBE is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of QBE's shares. Procedures are in place to ensure that items which potentially require announcement to the ASX are promptly notified to head office for assessment and released as required. The chief executive officer is responsible for authorising the release of market announcements. All market announcements are posted promptly to the Group's website.

QBE takes the spirit of its continuous disclosure obligations very seriously and issues frequent market announcements during the year to satisfy those obligations. A list of the material announcements made since 1 January 2006 is included on page 144.

#### Communication with shareholders

QBE distributes an annual report to all shareholders except those who elect not to receive it. QBE also produces a half year report, with a results summary sent to all shareholders except those who elect not to receive it. Both reports are available on the QBE website. The website also contains historical and other details on the Group. Shareholders can discuss their shareholding with either the shareholder services department or the share registrar, both located in Sydney.

The AGM is held in Sydney each year, usually in April. Shareholders are encouraged to attend the AGM in person or by proxy. Most resolutions in the notice of meeting have explanatory notes. During the AGM, shareholders may ask questions of either the chairman or the external auditor.

#### Communications with analysts, investors, media and others

The chief executive officer, chief financial officer, divisional chief executive officers, chief operating officer, chief risk officer and general counsel and company secretary generally deal with analysts, investors, media and others, taking account of regulatory guidelines including those issued by the ASX on continuous disclosure. The presentations on the 30 June and 31 December results and other major presentations are sent to the ASX before the presentations commence and are available promptly on the Group's website. The 30 June and 31 December presentations are also generally webcast.

#### Share trading guidelines

The company has guidelines for directors and senior Group executives relating to the purchase and sale of securities of the company. These are in addition to the insider trading provisions of the *Corporations Act 2001*. In particular, the guidelines state that directors and senior Group executives should:

- never actively trade the company's securities;
- not hedge unvested entitlements; and
- notify any intended transaction to nominated people within the Group.

The guidelines identify set periods during which directors or senior Group executives may buy or sell the company's securities, being three to 30 days after each of the release of the company's half year results, the release of the company's annual report and the date of the AGM, and also three days after the issue of any prospectus until the closing date. Any QBE share dealings by directors are promptly notified to the ASX.

#### Other Group guidelines

The Group has adopted a code of conduct for Australian operations, Group head office and Group investment division, which forms the basis for the manner in which these employees perform their work. The code of conduct requires that business be carried out in an open and honest manner

with our customers, shareholders, employees, regulatory bodies, outside suppliers, intermediaries and the community at large. The code also deals with confidentiality, conflicts of interest and related matters. The non-executive directors have adopted a code of conduct for themselves which is substantially the same as the code above.

Other divisions have or are developing codes of conduct based on the Group code above, with some differences to allow for the requirements of the particular country or countries in which the division operates.

There are other Group policies covering anti-discrimination, employment, harassment, QBE essential behaviours, health and safety, privacy, whistle-blowing and many other business practices. These policies are underpinned by the Group's vision and values statements. The vision and values statements form part of the induction information given to new employees. One of the core values of the Group is integrity.

QBE in Australia follows the general insurance code of practice, a self-regulated code developed by the Insurance Council of Australia relating to the provision of products and services to customers of the general insurance industry of Australia. A revised code commenced in July 2006.

QBE in Australia is a member of the Insurance Ombudsman Service, an ASIC approved external dispute resolution body for insurance disputes between consumers and insurers. Similar insurance practice rules apply to the Group in certain other countries outside Australia.

Details of indemnification and insurance arrangements are included in the directors' report on page 54.

The following documents are available in the corporate governance area of QBE's website or on request from the company secretary:

- board charter;
- audit, investment and remuneration committee charters;
- non-executive director nomination guidelines;
- code of conduct for non-executive directors;
- code of conduct for Australian operations, Group head office and Group investment division;
- guidelines for dealing in securities of QBE Insurance Group Limited or other companies by directors and senior Group executives;
- continuous disclosure guidelines; and
- shareholder communication guidelines.

#### Environmental issues

QBE is a corporation involved in an industry that seeks to play a role, in conjunction with governments, individuals and organisations, in managing and reducing environmental risk. In an initiative to collaborate with the United Nations environment programme, QBE, together with a number of other major international insurers, is a signatory to a statement of environmental commitment by the insurance industry.

Your directors present their report on the consolidated entity consisting of OBE Insurance Group Limited and the entities it controlled at the end of or during the year ended 31 December 2006.

## DIRECTORS

The following directors held office during the whole of the financial year and up to the date of this report:

EJ Cloney (chairman)  
 LF Bleasel AM  
 The Hon NF Greiner AC  
 IF Hudson  
 BJ Hutchinson  
 CLA Irby  
 IYL Lee  
 FM O'Halloran

Mr DM Boyle was appointed as a director on 28 September 2006.

At the 2007 annual general meeting ("AGM"), The Hon NF Greiner AC will retire. Mr Bleasel will retire by rotation and offers himself for re-election. Mr Boyle retires in accordance with article 74 of the company's constitution and offers himself for re-election.

Details of the directors and their qualifications are provided on page 45.

## CONSOLIDATED RESULTS

	2006 \$M	2005 \$M
<b>Revenue</b>		
Premium revenue	10,069	9,171
Other revenue	1,768	2,946
Net fair value gains on financial assets	207	217
Net fair value gains (losses) on investment properties	6	(1)
Realised (loss) gain on sale of controlled entities	(1)	11
Investment income – ABC financial assets pledged for funds at Lloyd's	122	84
	<b>12,171</b>	<b>12,428</b>
<b>Expenses</b>		
Outward reinsurance premium expense	1,911	1,785
Gross claims incurred	5,528	6,744
Other expenses	2,449	2,179
Expenses – ABC securities for funds at Lloyd's	143	101
Finance costs	128	96
<b>Profit before income tax</b>	<b>2,012</b>	<b>1,523</b>
Income tax expense	519	425
<b>Profit after income tax</b>	<b>1,493</b>	<b>1,098</b>
Net profit attributable to minority interest	10	7
<b>Net profit after income tax attributable to members of the company</b>	<b>1,483</b>	<b>1,091</b>

## PROFIT

The directors are pleased to announce a 36% increase in net profit after income tax to \$1,483 million for the year ended 31 December 2006 compared with \$1,091 million last year. The significant increase in profit reflects the continuation of favourable insurance conditions, the benefit of premium growth from acquisitions, the Group's geographic and product diversification, conservative reinsurance protections and improved investment yields.

## DIVIDENDS

The directors are also pleased to announce a final dividend of 55.0 cents per share, 60% franked, for the year ended 31 December 2006. The total dividend for 2006 is 95.0 cents per share, up 34% compared with 71.0 cents per share for the year ended 31 December 2005. The final dividend payout, including shares issued under the Dividend Reinvestment Plan ("DRP") and the Dividend Election Plan ("DEP"), is \$452 million compared with \$302 million last year. The DRP and DEP have been reinstated after having been suspended for the interim dividend in September 2006. The franking account balance on a tax paid basis, after taking into account the final dividend franked at 60%, is a surplus of \$90 million.



## ACTIVITIES

The principal activities of the company and its controlled entities during the year were underwriting general insurance and reinsurance risks, management of Lloyd's syndicates and investment management.

## SHAREHOLDERS' FUNDS

Shareholders' funds increased during the year by 23% to \$6,283 million at 31 December 2006. The number of shares advised to the Australian Stock Exchange increased from 794 million to 819 million mainly due to the conversion of hybrid securities and the reinvestment of dividends.

## REVIEW OF OPERATIONS

Gross earned premium was \$10,069 million, up 10% from last year. Premium growth was assisted by the acquisitions made in 2005, a continued high retention of business and the overall average increase in premium rates. New business growth was less than anticipated due to competition and our unwillingness to write business that did not meet our profit targets. Net earned premium increased 10% to \$8,158 million. After the elimination of internal reinsurance with our captive Equator Re, the Group's cost of reinsurance reduced as a percentage of gross written premium even though we incurred significant rate increases on the protections purchased for our reinsurance operations.

The ratio of claims, commissions and expenses to net earned premium (combined operating ratio) was 85.3% compared with 89.1% last year. All divisions produced strong underwriting results. The net claims ratio was 55.8% compared with 59.9% last year reflecting lower large catastrophe claims and the continued low frequency of attritional claims on most of our portfolios. Net claims above \$2.5 million from catastrophes and large individual risk losses in 2006 were 10.0% of net earned premium compared with 11.7% last year. The commission ratio increased slightly from 16.9% to 17.0% reflecting a change in the mix of business. The expense ratio was 12.5%, up slightly from 12.3% last year, mainly due to the acquisitions of intermediaries in Australia and higher IT costs.

### Australia Pacific Asia Central Europe

Australian general insurance combined operating ratio was 82.9% compared with 83.6% last year. The strong result was achieved from a continued low frequency of claims together with high customer retention and the lapsing of business which did not meet our profit criteria due to increased competition. Net earned premium of \$2,051 million was up 2% from the last year. Growth was affected by a reduction in overall average premium rates. The claims ratio decreased from 56.1% to 55.9%. The commission ratio decreased from 12.7% to 11.8% mainly due to benefits from the acquisition of intermediaries. The expense ratio increased from 14.8% last year to 15.2% due to expenses of the new intermediaries and higher IT costs to improve efficiency.

Pacific Asia Central Europe combined operating ratio was 84.4% compared with 82.3% last year. The deterioration was mainly due to premium rate reductions and an increase in the frequency of large property claims. Premium growth was affected by a reduction in overall average premium rates and increased competition. Net earned premium increased by 5% to \$563 million. The claims ratio increased from 40.8% to 42.0%. The commission ratio increased from 18.7% to 20.4% reflecting a change in the geographic and product mix of business and slightly higher commissions to retain business. The expense ratio decreased from 22.8% to 22.0% even though we commenced implementation of new IT systems in a number of countries.

### European operations

This division comprises two main business units: QBE Insurance (Europe) and our Lloyd's division trading as Limit. QBE Insurance (Europe), which includes company operations in the UK, Ireland and Western Europe, reported net earned premium growth of 13% to \$2,209 million. Premium growth benefited from the acquisitions made in 2005, partly offset by the transfer of reinsurance business to Limit and the effects of competition. The division produced a combined operating ratio of 88.8% compared with 90.0% last year. The combined operating ratio reflects the continued low frequency of claims in the majority of portfolios, partly offset by an increase in large individual risk claims. The net claims ratio was 62.2% compared with 62.3%. The commission ratio decreased from 15.3% to 14.5% from a change in the mix of business, primarily the effect of the British Marine acquisition. The expense ratio decreased from 12.4% last year to 12.1%, reflecting further synergies from restructures previously announced.

Lloyd's division combined operating ratio was 82.1% compared with 94.5% last year, reflecting the lower level of large catastrophes during the year and higher premium rates, principally on US catastrophe-exposed property and energy business. Net earned premium reduced by 6% to \$1,644 million due to increased competition and the effect of new proportional reinsurance to Equator Re. The claims ratio reduced from 63.6% to 49.4%. The commission ratio increased from 20.3% to 20.7% due to a change in the mix of business. The expense ratio increased from 10.6% last year to 12.0% due to higher incentives for increased profits, lower profit commissions from third party capital providers and increased IT costs due to the implementation of new systems.

the Americas

This division reported net earned premium growth of 37% to \$1,153 million due to the impact of the acquisitions made in 2005 and early 2006, higher overall average increases in premium rates and a continued high retention of business. The combined operating ratio was 89.7% compared with 92.9% last year due to the higher premium rates and a lower level of catastrophe claims. The net claims ratio decreased from 60.0% to 55.9%. The commission ratio increased marginally from 25.5% last year to 25.6% mainly due to lower profit commissions from proportional reinsurance protections. The expense ratio increased from 7.4% to 8.2% due to the higher expense ratio on growth in general insurance business, increased incentives for improved profitability and greater costs of new IT systems.

The provision for **outstanding claims** for the majority of Group entities is determined after consultation with internal and external actuaries. The outstanding claims assessment takes into account the statistical analysis of past claims, allowance for claims incurred but not reported, recoveries and future interest and inflation factors. As in previous years, the directors consider that substantial risk margins are required in addition to actuarial central estimates to cover uncertainties such as latency claims, changes in interest rates and superimposed inflation. The APRA prudential standards provide that, for our Australian licensed insurers, outstanding claims must be set at a level that provides a probability of at least 75% that the provision for outstanding claims will be adequate to settle claims as they become payable in the future. The directors and management have set an internal target range of 85% to 94% and the directors have satisfied themselves that the Group's outstanding claims provision is slightly in excess of the high end of this range.

**Net investment income** increased 14% to \$822 million reflecting the higher interest rates, strong cash flow from operations, strong equity markets and the short duration portfolio. The result includes net fair value gains on equities of \$104 million (\$130 million gain last year) and foreign exchange gains of \$18 million (\$3 million gain last year). The gross investment yield before finance costs, exchange gains and losses and investment expenses was unchanged at 5.2% compared with last year.

**Income tax** expense for the period reduced from 28% of profit before tax last year to 26%, primarily due to higher profits earned in lower tax countries, including Bermuda, the base for our captive reinsurer, Equator Re.

## GROUP INDEMNITIES

Article 115 of the company's constitution provides that the company indemnifies past and present directors, secretaries or other officers against any liability incurred by that person as a director, secretary or other officer of the company or its controlled entities. This indemnity does not apply to any liability (excluding legal costs):

- owed to the company or its controlled entities (e.g. breach of directors' duties);
- for a pecuniary penalty or compensation order under the *Corporations Act 2001*; or
- which did not arise out of conduct in good faith.

The indemnity extends to legal costs other than where:

- in civil proceedings, an exclusion above applies;
- in criminal proceedings, the person is found guilty;
- the person is liable for civil remedies in proceedings brought by the Australian Securities and Investment Commission ("ASIC"), a corresponding regulator in another jurisdiction or a liquidator (unless as part of the investigation before proceedings are commenced); or
- the court does not grant relief after an application under the *Corporations Act 2001* or corresponding legislation in another jurisdiction that the person acted honestly and having regard to all the circumstances ought fairly to be excused for negligence, default, breach of trust or breach of duty in civil proceedings.

Article 115 was revised at the 2006 AGM.

## DIRECTORS' AND OFFICERS' INSURANCE

The consolidated entity pays a premium each year in respect of a contract insuring directors, secretaries, senior managers and employees of the consolidated entity together with any natural person who is either a trustee of or a member of a policy committee for a superannuation plan established for the benefit of the consolidated entity's employees against liabilities past, present or future. The officers of the consolidated entity covered by the insurance contract include the directors listed on page 52, the secretary, DA Ramsay, and deputy secretaries, NG Drabsch and PE Barnes.

In accordance with normal commercial practice, disclosure of the total amount of premium payable under, and the nature of liabilities covered by, the insurance contract is prohibited by a confidentiality clause in the contract.

No such insurance cover has been provided for the benefit of any external auditor of the consolidated entity.

## DECLARATIONS BY THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER

The chief executive officer and the chief financial officer have provided declarations to the directors stating that the financial records and annual financial statements are in compliance with the *Corporations Act 2001* and applicable accounting standards. Reference is included on page 138 of the financial report.

## SIGNIFICANT CHANGES

There were no significant changes in the state of affairs of the consolidated entity during the financial year.

## EVENTS SUBSEQUENT TO THE BALANCE DATE

In December 2006, the consolidated entity announced the purchase of Praetorian Financial Group, a property and casualty insurer in the US. The purchase is subject to regulatory approvals and is expected to complete early in the second quarter of 2007. The purchase price is US\$0.8 billion and the fair value of net tangible assets at the date of acquisition is expected to be around US\$0.46 billion.

Since 31 December 2006, the consolidated entity has announced the purchase of Winterthur Holdings Inc., a property and casualty insurer in the US. The purchase is subject to regulatory approvals and is expected to complete during the second quarter of 2007. The purchase price is US\$1.16 billion and the fair value of net tangible assets at the date of acquisition is expected to be US\$0.78 billion.

Except for the items discussed above, no other matter or circumstance has arisen since 31 December 2006 that has significantly affected or may significantly affect:

- the consolidated entity's operations in future financial years;
- the results of those operations in future financial years; or
- the consolidated entity's state of affairs in future financial years.

## LIKELY DEVELOPMENTS

Information on likely developments in the consolidated entity's operations in future financial years and the expected results of those operations has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the consolidated entity.

## MEETINGS OF DIRECTORS

	FULL MEETINGS OF DIRECTORS <sup>(1)</sup>	MEETINGS OF COMMITTEES				
		AUDIT	CHAIRMAN'S	FUNDING	INVESTMENT	REMUNERATION
Number of meetings held	8	4	1	1	3	4
<b>Number attended</b>						
LF Bleasel AM	8	4	–	–	–	4
DM Boyle <sup>(2)</sup>	3	1	–	–	–	2
EJ Cloney	8	–	1	1	3	4
The Hon NF Greiner AC	8	4	1	–	–	4
IF Hudson	8	4	–	–	–	4
BJ Hutchinson	8	4	–	1	3	–
CLA Irby	8	–	–	–	3	–
IYL Lee	8	4	–	1	3	–
FM O'Halloran <sup>(3)</sup>	8	–	1	1	3	–

(1) Included a four day review meeting in London. In addition, directors attended quarterly meetings for each of the Australian regulated insurance companies.

(2) Mr Boyle was appointed on 28 September 2006.

(3) Mr O'Halloran attends audit and remuneration committee meetings by invitation, not being a member of those committees.

During the February, June and August 2006 board meetings, the board also met as the nomination committee to consider issues relevant to the appointment of non-executive directors. Further meetings occurred during the year, including meetings of the chairman and chief executive officer, meetings of the directors with management or regulators, and meetings of non-executive directors. From time to time, directors attend meetings of committees of which they are not currently members.

## DIRECTORSHIPS OF LISTED COMPANIES HELD BY THE MEMBERS OF THE BOARD

From 1 January 2004 to 31 December 2006 the directors also served as directors of the following listed companies:

	POSITION	DATE APPOINTED	DATE CEASED
<b>LF Bleasel AM</b>			
Foodland Associated Limited	Chairman <sup>(1)</sup>	11 March 2004	24 November 2005
St George Bank Limited	Director	27 May 1993	16 December 2005
<b>EJ Cloney</b>			
Boral Limited	Director	3 March 1998	-
Patrick Corporation Limited	Director	1 May 2003	11 May 2006
<b>The Hon NF Greiner AC</b>			
Bradken Limited	Chairman	13 April 2004	-
McGuigan Simeon Wines Limited	Director	11 September 1992	-
Stockland Trust Group	Deputy chairman	1 September 1992	-
<b>BJ Hutchinson</b>			
Coles Group Ltd	Director	23 September 2005	-
Crane Group Limited	Director	1 September 1997	9 June 2004
TAB Limited	Director	11 July 1997	6 July 2004
Telstra Corporation Limited	Director	16 November 2001	-
<b>CLA Irby</b>			
Aberdeen Asset Management plc	Chairman	1 August 1999	-
Great Portland Estates plc	Director	1 April 2004	-
North Atlantic Smaller Companies Investment Trust plc	Director	10 December 2002	-
<b>LYL Lee</b>			
Beyond International Limited	Director	30 September 1986	25 November 2004
BioTech Capital Limited	Director	14 June 2000	1 July 2004
Mariner Financial Limited	Director	5 September 1985	30 October 2006
Mariner Bridge Investments Limited	Executive chairman	26 October 2006	-
Record Funds Management Limited	Director	14 May 2002	31 August 2005
ALLCO Finance Group Limited (formerly Record Investments Limited)	Director	16 January 2001	9 June 2006
Ten Network Holdings Limited	Director	13 October 2000	-

(1) Mr Bleasel was appointed as a director of Foodland Associated Limited on 10 April 2002.

(2) Mr Boyle and Ms Hudson have no directorships relevant to this disclosure.

## QUALIFICATIONS AND EXPERIENCE OF COMPANY SECRETARIES

### DA Ramsay B Comm, LLB, LLM, FANZIF, FCIS

Mr Ramsay is general counsel and company secretary of QBE Insurance Group Limited. His legal career commenced in March 1986 with Freehills, where he worked in the general commercial and litigation areas. In June 1993, he joined QBE as general counsel. Since May 2001, he has acted as general counsel and company secretary for the consolidated entity. He is also a director or secretary of a number of QBE controlled entities and acts as chairman of the policy committee and a trustee respectively of QBE sponsored superannuation plans in Australia and New Zealand.

### NG Drabsch FCA, FAICD, FCIS

Mr Drabsch was appointed chief financial officer in 1994 and acts as deputy company secretary of QBE Insurance Group Limited in addition to being a director of a number of QBE controlled entities. He joined QBE in 1991 and was the company secretary for the consolidated entity from 1992 to 2001. Mr Drabsch has over 40 years experience in insurance and reinsurance management, finance and accounting, including 24 years as a practising chartered accountant. He is a member of the Finance & Advisory Committee to the Insurance Council of Australia ("ICA"). He was previously a member of other representative committees for the ICA in relation to the development of Australian accounting standards for general insurance.

### PE Barnes BEc, FCA

Mr Barnes is deputy company secretary of QBE Insurance Group Limited and company secretary of selected controlled entities in Australia. Mr Barnes has been company secretary of many of QBE's Australian companies since November 1991. He has been responsible for taxation matters in QBE's Australian operations for the past 18 years and was formerly an accounting manager in QBE's international division. Prior to joining QBE 19 years ago, Mr Barnes was a manager in the chartered accounting firm Horwath and Horwath. He has for the past 13 years been chairman of the ICA's taxation committee.

## DIRECTORS' INTERESTS AND BENEFITS

### (A) Ordinary share capital

Directors' interests in the ordinary share capital of the company at the date of this report are as follows:

DIRECTOR <sup>(1)</sup>	2006 NUMBER	2005 NUMBER
LF Bleasel AM	27,264	27,264
DM Boyle	—	—
EJ Cloney	685,377	734,917
The Hon NF Greiner AC <sup>(2)</sup>	65,715	55,505
IF Hudson	—	—
BJ Hutchinson	33,950	27,446
CLA Irby	15,000	15,000
IYL Lee	21,129	13,956
FM O'Halloran	1,135,939	1,023,499

(1) Amounts in the above table do not include interests attributable to personally related parties.

(2) During the year The Hon NF Greiner AC converted 10,000 warrants into 12,500 ordinary shares.

### (B) Conditional rights and options

At the date of this report, Mr O'Halloran had 130,488 (2005 138,038) conditional rights to ordinary shares of the company and 328,052 (2005 344,165) options over ordinary shares of the company under the Deferred Compensation Plan ("DCP"). Details of the DCP are provided in note 27 to the financial statements.

The names of all persons who currently hold options granted under the Employee Share and Option Plan ("the Plan") and conditional rights are entered in the registers kept by the company pursuant to section 168 of the *Corporations Act 2001* and the registers may be inspected free of charge.

### (C) Share loans

At the date of this report, Mr O'Halloran had a non-recourse loan of \$4,335,692 (2005 \$4,335,692) and a personal recourse loan of \$891,507 (2005 \$nil) for the purchase of shares in QBE Insurance Group Limited. Under Australian equivalents to International Financial Reporting Standards ("AIFRS"), non-recourse loans and the shares they purchase are derecognised and treated as options.

### (D) Related entity interests

Details of directors' and executives' interests with related entities are provided in note 28 to the financial statements.

## REMUNERATION REPORT

The following information is included in the remuneration report:

SECTION	REQUIRED BY
(A) Remuneration framework	AASB 124: Related Party Disclosures ("AASB 124") <sup>(1)</sup>
(B) Remuneration and reward structure	AASB 124 <sup>(1)</sup>
(C) Employment agreements	AASB 124 <sup>(1)</sup>
(D) Remuneration details	AASB 124 <sup>(1)</sup>
(E) Share based compensation	AASB 124 <sup>(1)</sup>
(F) At risk remuneration	<i>Corporations Act 2001</i> and <i>Corporations Regulations 2001</i> <sup>(2)</sup>
(G) Relationship between remuneration and company performance	<i>Corporations Act 2001</i> and <i>Corporations Regulations 2001</i> <sup>(2)</sup>

(1) AASB 124 permits these disclosures to be transferred from the financial report to the remuneration report. These disclosures have been audited.

(2) These disclosures are additional to those disclosures required under AASB 124 and have not been audited.

The remuneration report outlines the policy of the board in relation to the remuneration of the directors and executives of the consolidated entity. In addition, this report details the remuneration of key management personnel of the consolidated entity who are defined as the directors (executive and non-executive) and those persons having authority and responsibility for planning, directing and controlling the activities of the consolidated entity, either directly or indirectly.

#### **(A) Remuneration framework**

The remuneration committee of the board oversees remuneration practices. The committee assesses the appropriateness of remuneration policies and practices in order to fairly and responsibly reward executives, ensuring rewards are commensurate with performance, and that remuneration levels are market competitive in the various markets in which the consolidated entity operates.

##### **(i) Non-executive directors**

Non-executive director remuneration reflects the consolidated entity's desire to attract, motivate and retain high quality directors and to ensure their active participation in the consolidated entity's affairs for the purposes of corporate governance, regulatory compliance and other matters. The consolidated entity aims to provide a level of remuneration for non-executive directors comparable with its peers, which include multi-national financial institutions. The board reviews surveys published by independent remuneration consultants and other public information to ensure that fees paid are appropriate.

##### **(ii) Executives**

#### **Remuneration and reward philosophy**

Remuneration practices vary in each of the markets within which the consolidated entity operates, and therefore the diversity of individual roles and the complexity of each operating environment is considered. The remuneration committee recognises that the consolidated entity operates in a competitive environment, where the key to achieving sustained performance is to generally align executive reward with increasing shareholder wealth.

The guiding principles applied in managing remuneration and reward for executives combine:

- linking individual performance to the achievement of financial targets and business strategies;
- the achievement of short term and long term financial business targets that deliver sustained growth in value for shareholders (e.g. return on equity, insurance profit, return on capacity for our Lloyd's business and investment performance); and
- using market data to set fixed annual remuneration levels.

The remuneration committee seeks the advice of independent remuneration consultants to ensure that remuneration and reward levels are appropriate and are in line with market conditions in the various markets in which the consolidated entity operates. The remuneration committee endeavours to have remuneration structures in place that encourage the achievement of a return for shareholders in terms of both dividends and growth in share price.

#### **Short Term Incentive scheme**

The Short Term Incentive ("STI") scheme is a short term incentive arrangement in the form of an annual cash award, designed to reward both executives and the majority of staff. The STI aims to recognise the contributions and achievements of individuals when annual financial business targets relating to the performance of the business unit, the division or the consolidated entity as appropriate are achieved or exceeded.

#### **Deferred Compensation Plan**

Key management personnel and other executives are eligible to participate in a Deferred Compensation Plan ("DCP"). An executive is only entitled to participate in the DCP when an STI is earned. The DCP aims to attract and retain key executives and to increase shareholder value by motivating executives. It provides executives with the opportunity to acquire equity in the form of conditional rights to fully paid shares without payment by the executive, and options to subscribe for shares at market value at the grant date. Further details are provided in note 27 to the financial statements.

The remuneration committee reviews and approves the STI and the DCP terms annually, and approves the total quantum of short term incentive and deferred compensation for executives based on the applicable audited results.

The success of the incentive schemes is demonstrated by the extremely low turnover of senior staff and the wealth that has been created for shareholders, as demonstrated in the table on page 67.

(B) Remuneration and reward structure

(i) Non-executive directors

Non-executive director remuneration packages contain the following key elements:

COMPONENT	DESCRIPTION
Fees	Annual gross cash remuneration. The aggregate amount approved by shareholders at the 2004 AGM was \$2,200,000 per annum. The amount paid to individual non-executive directors may vary according to specific responsibilities, including involvement on the committees of the board. Non-executive directors may sacrifice future fees into the QBE non-executive directors share plan.
Other benefits	Non-executive directors do not receive any performance based remuneration such as cash bonuses or equity incentives. Under the company's constitution, non-executive directors are entitled to be paid all travel and related expenses properly incurred in connection with the business of the company.
Superannuation	Annual cost of superannuation contributions. The consolidated entity pays superannuation of 9% or an equivalent to non-executive directors.
Other retirement benefits	Non-executive directors previously received a retirement allowance based on their period of service. The allowance was limited to the aggregate of the director's fees in the last three years of service, subject to a minimum of 10 years service. Where service was less than 10 years, a pro-rata amount was paid. With effect from 31 December 2003, the board terminated the retirement allowance to non-executive directors. Directors' fees were increased by 30% as compensation. Accrued retirement benefits at 31 December 2003 are preserved until retirement and are subject to an annual increase equal to the average five year Australian government bond rate. Shareholders approved an increase in non-executive directors' remuneration and the company's constitution was amended at the 2004 AGM to recognise this change.

(ii) Executives

Executive remuneration packages contain the following key elements:

STRUCTURE	COMPONENT	DESCRIPTION
Total remuneration cost ("TRC")	Base salary	Annual gross cash salary.
	Other benefits	Benefits such as the value of motor vehicles, long service leave, health insurance, life assurance and personal accident insurance, and the applicable taxes thereon.
	Superannuation	Annual cost of employer superannuation contributions.
At risk remuneration	Short term incentive	Annual cash award delivered under the STI terms, substantially based on the achievement of specific financial targets. STI commences when the minimum return on equity requirements are met.
	Deferred compensation	<p>Annual incentive delivered under the DCP terms, granting conditional rights to fully paid shares and options to subscribe for shares at market value. The award is only granted when STI is earned.</p> <p>The DCP award quantum is restricted to the lesser of 66.67% of the STI award in that year or 100% of base salary or TRC as at 31 December in the financial year prior to the year in which the STI award is paid.</p> <p>The DCP award quantum is used to acquire conditional rights to fully paid shares and options respectively as follows:</p> <ul style="list-style-type: none"><li>• conditional rights to shares to the value of 60% of the DCP award; and</li><li>• options over ordinary shares to the value of 40% of the DCP award, with the resulting number multiplied by four until 2005, reducing to a multiplier of three in 2006.</li></ul> <p>Conditional rights and options relating to the achievement of targets in a financial year are granted in March of the following year. Interest free personal recourse loans are available on terms permitted by the Plan to persons in the employment of the company who hold options under the DCP, to fund the exercise of the options.</p> <p>Conditional rights and options issued in 2004 and prior financial years are exercisable after three years. Options issued in 2005 and future financial years are exercisable after five years, with the exception of options for staff in the Group investment division, which continue to be exercisable after three years.</p>

(iii) Incentive structure – FM O'Halloran

Consistent with other executives, Mr O'Halloran is entitled to an annual cash incentive award under the STI, calculated as a percentage of TRC, if specified targets are achieved. Mr O'Halloran's incentives are based on the achievement of the following range of target returns on opening shareholders' funds adjusted for dividends and increases in share capital ("return on equity") for the 2006 financial year, and are based on the consolidated entity's management basis of accounting which spreads realised and unrealised gains on equities and properties evenly over a period of seven years ("seven year spread basis").

The table below outlines the mix of Mr O'Halloran's incentives based on actual and target returns on equity:

	GROUP RETURN ON EQUITY %	STI AWARD AS A % OF TRC	PROPOSED DCP AWARD AS A % OF STI
Minimum target	14	15	10
Maximum target	21	134	89
Achieved	29	134	89

Subject to the approval by shareholders at the 2007 AGM, Mr O'Halloran, on a basis consistent with other executives, is entitled to receive conditional rights to fully paid shares and options to subscribe for shares under the DCP in relation to 2006 performance. These will be exercisable in three and five years respectively, or on Mr O'Halloran's retirement, whichever is earlier.

(iv) Incentive structure – other key management personnel

The table below summarises the financial targets for each executive defined as other key management personnel of the consolidated entity. These targets are generally consistent with the targets applicable to the chief executive officer. The result used for determining incentive payments and the maximum STI that can be earned for the 2006 financial year are generally expressed as a percentage of base salary or TRC as appropriate.

	FINANCIAL TARGET	MAXIMUM STI AS A % OF REMUNERATION	RESULT BASIS
<b>Key management personnel</b>			
SP Burns	European operations insurance profit %	133% x TRC	Financial year result
NG Drabsch	QBE Group return on equity	117% x TRC	Financial year result (seven year spread basis)
TM Kenny	the Americas insurance profit %	133% x base salary	Financial year result
V McLenaghan <sup>(1)</sup>	Australia Pacific Asia Central Europe operations return on equity	133% x TRC	Financial year result
PE Grove	European operations insurance profit %	100% x TRC	Financial year result
	Limit syndicate 566 underwriting year result	0.5% of syndicate 566 profits	
MD ten Hove	Investment income as a % of budget income and individual performance measures	125% x TRC	Financial year result
<b>Former key management personnel<sup>(2)</sup></b>			
RL Jones <sup>(3)</sup>	–	–	–
EG Tollifson <sup>(4)</sup>	QBE Group return on equity	94% x TRC	Financial year result (seven year spread basis)

(1) From 1 January 2006 to 15 August 2006, Mr McLenaghan's STI award was 125% of TRC.

(2) These persons ceased being key management personnel from 1 July 2006.

(3) Mr Jones ceased employment on 31 October 2006.

(4) Ms Tollifson ceased employment on 3 July 2006.

(C) Employment agreements

Mr O'Halloran (executive director) and other key management personnel are employed by various controlled entities within the consolidated entity on a permanent full time basis with an open ended contract. Upon termination of employment, the executive director and other key management personnel receive their statutory entitlements of accrued annual and long service leave (where applicable), together with any superannuation benefits. Written notice is usually required in the event of termination of employment. In the case of a voluntary termination prior to retirement age, executives forfeit all conditional rights to ordinary shares not yet vested and unexercised options under the DCP.

In the event that the contract of employment is terminated through redundancy, retirement through ill health or age (subject to a minimum of 10 years service), or death and no disciplinary procedure or notice is pending, the executive is entitled to the outstanding STI and DCP awards for previous years plus a pro-rata share of the STI and conditional rights for the current financial year.



For certain executives (including some key management personnel), the controlled entities have entered into employment agreements that provide for payment of benefits in the event that the agreement is terminated by either the controlled entity or the executive. The agreements generally provide for the following:

- a notice period up to one year;
- where the controlled entity terminates the agreement, a payment comprised of TRC or base salary as appropriate plus STI for the relevant period; and
- in certain circumstances, where the controlled entity or the executive terminates the agreement due to material diminution in role, a payment of up to one year's TRC or base salary as appropriate plus STI for the relevant period.

The exceptions to the general provisions are described below.

In the event of material diminution in role or responsibility, in certain circumstances Mr ten Hove is entitled to a payment equivalent to TRC from the date of termination to 1 January 2008 plus one year's STI based on the average payment in the preceding three years, plus the accelerated vesting of all conditional rights and options.

In the event of material diminution in role or responsibility, in certain circumstances Mr Kenny is entitled to a payment equivalent to two years' TRC plus the accelerated vesting of all conditional rights and options that would otherwise have vested in the two years following the termination date.

Subject to the achievement of financial hurdles, Mr Kenny will receive a contractually agreed bonus payment on 12 May 2011 of one year's base salary. In addition, 100,000 future performance options will be granted at \$20.44 in tranches of 20,000 over a five year period commencing March 2007 and vesting within three months of December 2010.

Subject to the achievement of financial hurdles, Mr Burns will receive a contractually agreed bonus payment on 31 December 2010 of one year's TRC. In addition, 100,000 future performance options will be granted at \$20.44 in tranches of 20,000 over a five year period commencing March 2007 and vesting within three months of December 2010.

#### (D) Remuneration details

The following tables provide details of the remuneration of key management personnel of the consolidated entity.

	YEAR	SHORT TERM	POST EMPLOYMENT BENEFITS		TOTAL
		EMPLOYEE BENEFITS			
		DIRECTORS' FEES <sup>(1)</sup>	SUPERANNUATION <sup>(2)</sup>	RETIREMENT BENEFITS <sup>(3)</sup>	
		\$'000	\$'000	\$'000	\$'000
Non-executive directors					
LF Bleasel AM	2006	115	105	6	226
	2005	187	17	6	210
DM Boyle <sup>(4)</sup>	2006	51	5	-	56
	2005	-	-	-	-
EJ Cloney	2006	408	135	26	569
	2005	494	44	26	564
CP Curran AO <sup>(5)</sup>	2006	-	-	-	-
	2005	53	5	5	63
The Hon NF Greiner AC	2006	214	19	21	254
	2005	194	17	20	231
IF Hudson <sup>(6)</sup>	2006	214	-	-	214
	2005	31	-	-	31
BJ Hutchinson	2006	203	18	14	235
	2005	189	17	13	219
CLA Irby	2006	221	-	5	226
	2005	206	-	5	211
IYL Lee	2006	216	19	4	239
	2005	187	17	4	208
Total	2006	1,642	301	76	2,019
	2005	1,541	117	79	1,737

(1) Includes fees paid for services on board committees.

(2) Mr Irby and Ms Hudson are UK residents. They receive a superannuation equivalent of 9% of fees which is included in directors' fees in the table above.

(3) Retirement benefits reflect the adjustment to the amounts preserved at 31 December 2003, being an annual increase equal to the five year Australian government bond rate.

(4) Mr Boyle was appointed on 28 September 2006.

(5) Mr Curran retired on 8 April 2005.

(6) Ms Hudson was appointed on 4 November 2005.

	YEAR	SHORT TERM EMPLOYEE BENEFITS			POST EMPLOYMENT BENEFITS	OTHER LONG TERM EMPLOYMENT BENEFITS	SHARE BASED PAYMENTS <sup>(2)</sup>		TERMINATION BENEFITS	TOTAL
		BASE SALARY \$'000	OTHER <sup>(3)</sup> \$'000	STI <sup>(4)</sup> \$'000	SUPER- ANNUATION \$'000	LONG SERVICE LEAVE \$'000	CONDITIONAL RIGHTS \$'000	OPTIONS \$'000	\$'000	\$'000
Executive director										
FM O'Halloran	2006	1,295	436	2,088	191	115	663	262	–	5,050
	2005	1,115	434	1,816	167	75	496	201	–	4,304
Other key management personnel										
SP Burns <sup>(1)</sup>	2006	1,160	396	2,168	–	–	841	442	–	5,007
	2005	1,074	255	1,914	45	–	594	350	–	4,232
NG Drabsch	2006	702	262	1,012	105	22	385	141	–	2,629
	2005	668	240	967	98	18	300	261	–	2,552
TM Kenny <sup>(1)</sup>	2006	1,019	130	1,355	35	–	513	294	–	3,346
	2005	971	1,166	1,291	35	–	460	289	–	4,212
V McLenaghan	2006	667	168	1,064	100	38	280	102	–	2,419
	2005	590	170	750	88	22	193	104	–	1,917
PE Grove <sup>(1)</sup>	2006	958	302	1,857	70	–	695	307	–	4,189
	2005	907	975	2,512	272	–	530	295	–	5,491
MD ten Hove	2006	725	244	966	134	–	254	117	–	2,440
	2005	697	395	897	137	–	117	53	–	2,296
Former key management personnel <sup>(5)</sup>										
RL Jones <sup>(6)(7)</sup>	2006	445	258	–	75	9	237	99	1,236	2,359
	2005	530	271	720	85	13	294	175	–	2,088
EG Tollifson <sup>(8)</sup>	2006	251	86	271	37	5	(63)	(154)	–	433
	2005	479	115	517	71	14	157	111	–	1,464
Total	2006	7,222	2,282	10,781	747	189	3,805	1,610	1,236	27,872
	2005	7,031	4,021	11,384	998	142	3,141	1,839	–	28,556

(1) Mr Kenny is located in New York and Messrs Burns and Grove are located in London. Their remuneration has been converted to Australian dollars using the cumulative average rates of exchange for the year.

(2) The fair value at grant date of options and conditional rights is calculated using a binomial model. The fair value of each option and conditional right is earned evenly over the period between grant and vesting. Details of grants of conditional rights and options are provided in note 28 to the financial statements.

(3) "Other" includes the deemed value of the provision of motor vehicles, health insurance, life assurance and personal accident insurance and the applicable taxes thereon. Directors' and officers' liability insurance has not been included in other remuneration since it is not possible to determine an appropriate allocation basis. It also includes interest on share loans, also disclosed in note 28(E) to the financial statements.

(4) STI is the accrued entitlement for the financial year.

(5) These persons ceased being key management personnel from 1 July 2006. Their remuneration included in the above table is for their period of employment.

(6) Mr Jones ceased employment on 31 October 2006 after reaching 55 years of age. Included in termination benefits is the cost attributable to the accelerated recognition of conditional rights and options, where the DCP terms permitted exercise of these instruments before the original exercise date.

(7) Mr Jones may be entitled to a further termination payment of \$960,000 subject to achieving certain criteria included in his termination arrangements.

(8) Ms Tollifson ceased employment on 3 July 2006. As a result, she relinquished her entitlement to a DCP award for the 2006 financial year. The credit amount shown for share based payments reflects the reversal of charges in respect of unvested conditional rights and options under previous DCP awards.

(E) Share based compensation

(i) Options

DCP options

DCP options affecting remuneration of key management personnel in the previous, this or future reporting periods are as follows:

GRANT DATE	DATE EXERCISABLE	EXPIRY DATE	EXERCISE PRICE	VALUE PER OPTION AT GRANT DATE <sup>(1)</sup>
18 March 2002	17 March 2005	18 March 2006	\$7.49	\$1.47
13 March 2003	13 March 2006	13 March 2007	\$8.04	\$1.45
10 April 2003	9 April 2006	10 April 2007	\$8.04	\$1.74
3 March 2004	2 March 2007	3 March 2008	\$8.04	\$3.61
3 March 2004	2 March 2007	3 March 2008	\$11.08	\$2.12
2 April 2004	1 April 2007	2 April 2008	\$11.08	\$2.23
3 March 2005	3 March 2008	3 March 2009	\$14.85	\$3.04
3 March 2005	3 March 2010	3 March 2011	\$8.04	\$6.90
3 March 2005	3 March 2010	3 March 2011	\$11.08	\$5.17
3 March 2005	3 March 2010	3 March 2011	\$14.85	\$3.60
8 April 2005	8 April 2010	8 April 2011	\$14.85	\$3.60
2 March 2006	1 March 2009	2 March 2010	\$20.44	\$3.85
2 March 2006	1 March 2011	2 March 2012	\$20.44	\$4.58
7 April 2006	6 April 2011	7 April 2012	\$20.44	\$5.63

(1) The fair value at grant date of DCP options is calculated using a binomial model. The fair value of each option is earned evenly over the three or five year period between grant and vesting.

Details of DCP options over the ordinary shares in the company provided as remuneration to the key management personnel are set out below. When exercisable, each option is convertible into one ordinary share of the company.

NAME	NUMBER OF OPTIONS GRANTED IN THE YEAR		NUMBER OF OPTIONS VESTED AND EXERCISED IN THE YEAR <sup>(1)</sup>	
	2006	2005	2006	2005
<b>Executive director</b>				
FM O'Halloran	94,771	118,587	110,884	—
<b>Other key management personnel</b>				
SP Burns	110,515	163,522	78,206	—
NG Drabsch	50,460	67,350	62,381	—
TM Kenny	68,986	75,750	144,747	—
V McLenaghan	39,141	48,487	22,287	19,794
PE Grove	95,853	122,969	113,470	—
MD ten Hove	46,799	66,707	—	—
<b>Former key management personnel<sup>(2)</sup></b>				
RL Jones <sup>(3)</sup>	37,575	50,283	236,122	40,087
EG Tollifson <sup>(4)</sup>	26,981	34,740	33,931	—

(1) The amount paid for each option exercised in the year was \$8.04 (2005 \$7.49).

(2) These persons ceased being key management personnel from 1 July 2006.

(3) Mr Jones ceased employment on 31 October 2006.

(4) Ms Tollifson ceased employment on 3 July 2006.

# Future performance options

Future performance options affecting remuneration of key management personnel in the previous, this or future reporting periods are as follows:

GRANT DATE	DATE EXERCISABLE	EXPIRY DATE	EXERCISE PRICE	VALUE PER RIGHT AT GRANT DATE <sup>(1)</sup>
25 May 2001	24 May 2006	25 May 2006	\$10.65	\$2.35
1 June 2001	31 May 2006	1 June 2006	\$10.69	\$2.37
10 December 2001	31 March 2007	1 April 2007	\$7.27	\$1.62
18 March 2002	31 March 2005	1 April 2005	\$7.49	\$1.37
14 November 2002	31 December 2005	14 March 2006	\$7.37	\$1.34
12 May 2005	20% in December each year	30 December 2009	\$14.81	\$2.32

(1) The fair value at grant date of options is calculated using a binomial model. The fair value of each option is earned evenly over the period between grant and vesting.

The specific terms and conditions of each grant of future performance options that affect remuneration of the key management personnel in the previous, this or future reporting periods are as follows:

GRANT DATE	PERFORMANCE CRITERIA	NAME	NUMBER OF OPTIONS GRANTED
25 May 2001	Limit to achieve an average 5% return on capacity for five years from the 2001 underwriting year	SP Burns PE Grove	35,000 35,000
1 June 2001	QBE the Americas to achieve an average insurance profit of 6% for underwriting years 2001 to 2005	TM Kenny	30,000
10 December 2001	Limit to achieve an average 5% return on capacity for five years from and including the 2002 underwriting year	SP Burns PE Grove	80,000 60,000
	QBE the Americas to achieve an average insurance profit of 5% for underwriting years 2002 to 2006	TM Kenny	100,000
18 March 2002	QBE Group to achieve an average annual 12.5% increase in earnings per share over three years to 31 December 2004	NG Drabsch EG Tollifson	100,000 100,000
14 November 2002	Limit managed syndicates to achieve an average return on capacity of 7% or more over the financial years 2002 to 2005	PE Grove	100,000
12 May 2005	QBE the Americas to achieve an average insurance profit of 7% of net earned premium for the five underwriting years commencing 1 January 2001	TM Kenny	100,000

Details of future performance options over the ordinary shares in the company provided as remuneration to the key management personnel are set out below. When exercisable, each option is convertible into one ordinary share of the company.

NAME	NUMBER OF OPTIONS VESTED IN THE YEAR		NUMBER OF OPTIONS EXERCISED IN THE YEAR		AMOUNT PAID PER SHARE	
	2006	2005	2006	2005	2006	2005
<b>Key management personnel</b>						
SP Burns	35,000	—	35,000	—	\$10.65	—
NG Drabsch	—	100,000	—	100,000	—	\$7.49
TM Kenny	30,000	—	30,000	—	\$10.69	—
	20,000	20,000	20,000	—	\$14.81	—
PE Grove	—	100,000	100,000	—	\$7.37	—
	35,000	—	35,000	—	\$10.65	—
<b>Former key management personnel<sup>(1)</sup></b>						
EG Tollifson <sup>(2)</sup>	—	100,000	—	100,000	—	\$7.49

(1) These persons ceased being key management personnel from 1 July 2006.

(2) Ms Tollifson ceased employment on 3 July 2006.

### Regular options

Regular options issued under the Employee Share and Option Plan ("the Plan") are based on the achievement of past performance hurdles and are exercisable at 20% per annum. If the executive is entitled to exercise options in a particular year but does not, then he or she may exercise the options in the following year. These options expire if not exercised within five years from the grant date.

Regular options have been generally phased out and replaced with equity incentive arrangements under the DCP. There were no regular options issued during this or the previous reporting period.

Details of regular options affecting remuneration in the previous, this or future reporting periods are as follows:

GRANT DATE	DATE EXERCISABLE	EXPIRY DATE	EXERCISE PRICE	VALUE PER RIGHT AT GRANT DATE <sup>(1)</sup>
1 June 2000	20% per annum on anniversary of grant date	1 June 2005	\$6.53	\$1.16
1 October 2000	20% per annum on anniversary of grant date	1 October 2005	\$8.63	\$1.53
2 April 2001	20% per annum on anniversary of grant date	2 April 2006	\$10.72	\$1.74

(1) The fair value at grant date of options is calculated using a binomial model. The fair value of each option is earned evenly over the period between grant and vesting.

Details of regular options over the ordinary shares in the company provided as remuneration to the key management personnel are set out below. When exercisable, each option is convertible into one ordinary share of the company.

	NUMBER OF OPTIONS VESTED AND EXERCISED IN THE YEAR		AMOUNT PAID PER SHARE	
	2006	2005	2006	2005
<b>Key management personnel</b>				
TM Kenny	–	10,000	–	\$6.53
V McLenaghan	–	1,500	–	\$8.63
	<b>750</b>	<b>750</b>	<b>\$10.72</b>	<b>\$10.72</b>
<b>Former key management personnel<sup>(1)</sup></b>				
RL Jones <sup>(2)</sup>	–	3,000	–	\$8.63
	<b>1,500</b>	<b>1,500</b>	<b>\$10.72</b>	<b>\$10.72</b>
EG Tollifson <sup>(3)</sup>	–	2,000	–	\$8.63
	<b>1,000</b>	<b>1,000</b>	<b>\$10.72</b>	<b>\$10.72</b>

(1) These persons ceased being key management personnel from 1 July 2006.

(2) Mr Jones ceased employment on 31 October 2006.

(3) Ms Tollifson ceased employment on 3 July 2006.

### (ii) Conditional rights

Details of conditional rights affecting remuneration of key management personnel in the previous, this or future reporting periods are as follows:

GRANT DATE	DATE EXERCISABLE	VALUE PER RIGHT AT GRANT DATE <sup>(1)</sup>
18 March 2002	17 March 2005	\$8.40
13 March 2003	13 March 2006	\$9.16 to \$9.71
10 April 2003	10 April 2006	\$9.16
3 March 2004	2 March 2007	\$11.65 to \$13.24
2 April 2004	1 April 2007	\$12.49
3 March 2005	2 March 2008	\$15.30 to \$17.81
8 April 2005	7 April 2008	\$16.94
2 March 2006	1 March 2009	\$23.09
7 April 2006	6 April 2009	\$24.23

(1) The fair value at grant date of conditional rights is calculated using a binomial model. The fair value of each conditional right is earned evenly over the three year period between grant and vesting.

Details of conditional rights over the ordinary shares in the company provided as remuneration to the key management personnel are set out below. When exercisable, each conditional right is convertible into one ordinary share of the company.

	NUMBER OF RIGHTS GRANTED IN THE YEAR		NUMBER OF RIGHTS VESTED IN THE YEAR	
	2006	2005	2006	2005
<b>Executive director</b>				
FM O'Halloran	35,539	44,470	47,900	–
<b>Other key management personnel</b>				
SP Burns	41,444	61,321	33,784	–
NG Drabsch	18,923	25,256	26,947	–
TM Kenny	25,870	28,406	62,527	–
V McLenaghan	14,678	18,183	9,628	8,586
PE Grove	35,945	46,116	49,017	–
MD ten Hove	17,549	25,015	–	–
<b>Former key management personnel<sup>(1)</sup></b>				
RL Jones <sup>(2)</sup>	14,091	18,856	98,278	17,388
EG Tollifson <sup>(3)</sup>	10,118	13,027	14,658	–

(1) These persons ceased being key management personnel from 1 July 2006.

(2) Mr Jones ceased employment on 31 October 2006.

(3) Ms Tollifson ceased employment on 3 July 2006.

#### (F) At risk remuneration

Total reward mix

Consistent with market practice, the mix of total remuneration and reward is dependent on the level of seniority of the executive.

Total reward mix achieved for the current reporting period is as follows:

	TOTAL REWARD MIX <sup>(1)</sup>		
	TRC/BASE %	STI %	DCP %
<b>Executive director</b>			
FM O'Halloran	31	42	27
<b>Other key management personnel</b>			
SP Burns	30	41	29
NG Drabsch	35	40	25
TM Kenny	35	40	25
V McLenaghan	34	40	26
PE Grove	30	41	29
MD ten Hove	35	39	26
<b>Former key management personnel<sup>(2)</sup></b>			
RL Jones <sup>(3)</sup>	100	–	–
EG Tollifson <sup>(4)</sup>	68	32	–

(1) Except for Mr ten Hove, all of the above persons achieved their maximum entitlement under the STI and DCP awards in 2006. Mr ten Hove's maximum entitlement was based on the following mix: TRC 32%; STI 41%; and DCP 27%.

(2) These persons ceased being key management personnel from 1 July 2006.

(3) Mr Jones ceased employment on 31 October 2006.

(4) Ms Tollifson ceased employment on 3 July 2006.

#### (G) Relationship between remuneration and company performance

Remuneration and reward structures encourage the achievement of a return for shareholders in terms of both dividends and growth in share price. A significant component of executive remuneration is "at risk", ensuring a direct link between the consolidated entity's performance and the reward for executives. Details of "at risk" remuneration are included earlier in this report. Overall levels of executive reward take into account the performance of the Group over a number of years, with greater emphasis given to the current year. The use of financial targets ensures that executives focus on delivering superior returns to shareholders.

Over the period from 2002 to 2006:

- the consolidated entity's net profit after income tax has increased by an average of 52% per annum;
- dividends per share have increased by an average 28% per annum; and
- the share price has increased from \$8.15 to \$28.85, an average of 37% per annum.

During the same period, average executive remuneration including incentives has grown by approximately 15% per annum.

The consolidated entity's strong results in the last five years across a number of key performance indicators are summarised below:

	2002	2003	2004	2005	2006
<b>Earnings</b>					
Net profit after income tax (\$M)	279	572	857	1,091	<b>1,483</b>
Basic earnings per share (cents per share)	42.7	86.5	123.4	144.3	<b>186.4</b>
<b>Return on equity</b>					
Return on average shareholders' funds (%)	10.0	18.3	24.5	23.9	<b>26.1</b>
<b>Returns to shareholders</b>					
Dividends paid (cents per share)	35.0	42.0	54.0	71.0	<b>95.0</b>
Share price at 31 December (\$ per share)	8.15	10.60	15.35	19.60	<b>28.85</b>

## ENVIRONMENTAL REGULATION

The consolidated entity's operations are not subject to any significant environmental regulations under either Commonwealth or State legislation.

## AUDITOR

PricewaterhouseCoopers, Chartered Accountants, continues in office in accordance with section 327B of the *Corporations Act 2001*.

## NON-AUDIT SERVICES

During the year PricewaterhouseCoopers has performed certain other services in addition to its statutory duties.

The board of directors has considered the position and, in accordance with the advice received from the audit committee, is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The directors are satisfied that the provision of non-audit services by the auditor, as provided in note 30 to the financial statements, did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the audit committee to ensure that they do not impact the impartiality and objectivity of the auditor; and
- none of the services undermine the general principles relating to auditor independence as set out in Professional Statement F1, including reviewing or auditing the auditor's own work, acting in a management or a decision making capacity for the company, acting as advocate for the company or jointly sharing economic risk and rewards.

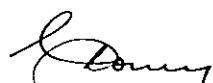
A copy of the auditor's independence declaration required under section 307C of the *Corporations Act 2001* is set out on page 68.

Details of amounts paid or payable to PricewaterhouseCoopers for audit and non-audit services are provided in note 30 to the financial statements.

## ROUNDING OF AMOUNTS

The company is of a kind referred to in the ASIC class order 98/0100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the directors' report. Amounts have been rounded off in the directors' report to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with that class order.

Signed in SYDNEY this 23rd day of February 2007 in accordance with a resolution of the directors.



**EJ Cloney**  
Director



**FM O'Halloran**  
Director

## AUDITOR'S INDEPENDENCE DECLARATION FOR THE YEAR ENDED 31 DECEMBER 2006

As lead auditor for the audit of QBE Insurance Group Limited for the year ended 31 December 2006, I declare that, to the best of my knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of QBE Insurance Group Limited and the entities it controlled during the period.



**RD Deutsch**  
Partner

Sydney  
23 February 2007

Liability limited by a scheme approved under the Professional Standards Legislation.



# Annual financial report

31 DECEMBER 2006

<b>Financial report</b>	
Income statements	70
Balance sheets	71
Statements of recognised income and expense	72
Statements of cash flows	73
Notes to the financial statements	75
Directors' declaration	138
Independent audit report to the members	139

This financial report includes separate financial statements for QBE Insurance Group Limited ('the company') as an individual entity and the consolidated entity consisting of QBE Insurance Group Limited and its controlled entities. The financial report is presented in Australian dollars.

QBE Insurance Group Limited is a company limited by shares, incorporated and domiciled in Australia. Its registered office is:

Level 2, 82 Pitt Street  
Sydney NSW 2000 Australia

A description of the nature of the consolidated entity's operations and its principal activities is included in the operations overview on pages 24 to 25 and in the directors' report, neither of which is part of this financial report.

The financial report was authorised for issue by the directors on 23 February 2007.

Through the use of the internet, we have ensured that our corporate reporting is timely, complete and available globally at minimum cost to the company. All material press releases, financial reports and other information are available at our QBE investor centre on our website: [www.qbe.com](http://www.qbe.com)

		THE COMPANY		CONSOLIDATED	
	NOTE	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Revenue</b>					
Premium revenue		-	-	10,069	9,171
Other revenue		2,352	520	1,768	2,946
Net fair value gains on financial assets		2	-	207	217
Net fair value gains (losses) on investment properties		-	-	6	(1)
Realised gain (loss) on sale of controlled entities		16	629	(1)	11
Investment income – ABC financial assets pledged for funds at Lloyd's		30	48	122	84
	6	2,400	1,197	12,171	12,428
<b>Expenses</b>					
Outward reinsurance premium expense		-	-	1,911	1,785
Gross claims incurred		-	-	5,528	6,744
Other expenses	7(C)	16	6	2,449	2,179
Expenses – ABC securities for funds at Lloyd's		59	45	143	101
Finance costs		74	93	128	96
<b>Profit before income tax</b>	7	2,251	1,053	2,012	1,523
Income tax (credit) expense	8	(28)	(7)	519	425
<b>Profit after income tax</b>		2,279	1,060	1,493	1,098
Net profit attributable to minority interest		-	-	10	7
<b>Net profit after income tax attributable to members of the company</b>		2,279	1,060	1,483	1,091

	NOTE	CONSOLIDATED	
		2006 CENTS	2005 CENTS
Basic earnings per share	36	186.4	144.3
Diluted earnings per share	36	178.5	135.0

The above income statements should be read in conjunction with the accompanying notes.

		THE COMPANY		CONSOLIDATED	
	NOTE	2006 \$M	2005 \$M	2006 \$M	2005 \$M
ASSETS					
Cash and cash equivalents	10	13	14	1,019	1,061
Financial assets at fair value through the income statement	11	62	40	18,915	16,503
ABC financial assets pledged for funds at Lloyd's	34	–	–	995	1,032
Derivative financial instruments	12	4	11	102	82
Receivables	13	1,488	1,928	3,837	3,607
Current tax assets		–	–	3	–
Reinsurance and other recoveries on outstanding claims	22	–	–	3,624	4,213
Other assets		64	56	6	5
Deferred insurance costs	14	–	–	1,409	1,446
Retirement benefit surplus	29	–	–	2	2
Property, plant and equipment	15	–	–	260	232
Deferred tax assets	16	6	–	72	67
Investment properties	17	–	–	38	33
Shares in controlled entities	18	9,669	6,427	–	–
Intangible assets	19	–	–	1,475	1,382
<b>Total assets</b>		<b>11,306</b>	<b>8,476</b>	<b>31,757</b>	<b>29,665</b>
LIABILITIES					
Trade and other payables	20	2,783	1,457	1,466	1,282
Derivative financial instruments	12	10	4	37	35
Current tax liabilities		101	144	193	162
Unearned premium	21	–	–	4,642	4,287
ABC securities for funds at Lloyd's	34	–	–	946	1,015
Swaps relating to ABC securities	34	5	5	58	29
Outstanding claims	22	–	–	15,269	15,083
Provisions	23	22	13	66	64
Retirement benefit deficit	29	–	–	8	168
Deferred tax liabilities	16	–	10	359	251
Interest bearing liabilities	24	745	1,145	2,364	2,130
<b>Total liabilities</b>		<b>3,666</b>	<b>2,778</b>	<b>25,408</b>	<b>24,506</b>
<b>Net assets</b>		<b>7,640</b>	<b>5,698</b>	<b>6,349</b>	<b>5,159</b>
EQUITY					
Share capital	25(A)	3,461	3,195	3,461	3,195
Treasury shares held in trust	25(B)	–	–	(16)	–
Equity component of hybrid securities	25(C)	108	108	108	108
Reserves	26(A)	44	33	47	(20)
Retained profits	26(B)	4,027	2,362	2,683	1,810
<b>Shareholders' funds</b>		<b>7,640</b>	<b>5,698</b>	<b>6,283</b>	<b>5,093</b>
Minority interest	18(D)	–	–	66	66
<b>Total equity</b>		<b>7,640</b>	<b>5,698</b>	<b>6,349</b>	<b>5,159</b>

The above balance sheets should be read in conjunction with the accompanying notes.

		THE COMPANY		CONSOLIDATED	
	NOTE	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Amounts recognised in equity</b>					
Net increase (decrease) in foreign currency translation reserve	26(A)	–	–	13	(24)
Actuarial gains (losses) on defined benefit superannuation plans, net of tax	26(B)	–	–	4	(27)
Cash flow hedges, net of tax	26(A)	7	(5)	17	(5)
Gains on revaluation of owner occupied properties, net of tax	26(A)	–	–	9	2
Employee share options, net of tax	26(A)	4	23	28	36
Net income (expense) recognised directly in equity		11	18	71	(18)
<b>Amounts recognised in income statement</b>					
Profit after income tax		2,279	1,060	1,493	1,098
<b>Total recognised income and expense for the year</b>		<b>2,290</b>	<b>1,078</b>	<b>1,564</b>	<b>1,080</b>
Attributable to:					
Equity holders		2,290	1,078	1,554	1,073
Minority interest		–	–	10	7
		<b>2,290</b>	<b>1,078</b>	<b>1,564</b>	<b>1,080</b>

The above statements of recognised income and expense should be read in conjunction with the accompanying notes.

		THE COMPANY		CONSOLIDATED	
	NOTE	2006 \$M	2005 \$M	2006 \$M	2005 \$M
OPERATING ACTIVITIES					
Premium received		-	-	10,483	8,756
Reinsurance and other recoveries received		-	-	1,805	1,309
Outward reinsurance paid		-	-	(1,874)	(1,479)
Claims paid		-	-	(6,025)	(4,620)
Insurance costs paid		-	-	(2,044)	(1,748)
Other underwriting costs		-	-	(379)	(343)
Interest received		53	3	611	562
Dividends received		1,085	262	45	44
Other operating income		5	-	30	-
Other operating payments <sup>(1)</sup>		(1)	(23)	(171)	(208)
Interest paid		(65)	(49)	(84)	(115)
Income taxes recovered (paid)		9	(6)	(358)	(171)
<b>Net cash flows from operating activities</b>	<b>38</b>	<b>1,086</b>	<b>187</b>	<b>2,039</b>	<b>1,987</b>
INVESTING ACTIVITIES					
Proceeds on sale of equity investments		-	-	418	1,403
Proceeds on sale of investment property		-	-	1	1
Proceeds on sale of property, plant and equipment		-	-	2	2
Payments for purchase of equity investments		-	-	(1,376)	(589)
Proceeds from foreign exchange transactions		-	-	39	188
Payments for purchase of other financial assets		(19)	(40)	(817)	(2,755)
Payments for purchase of controlled entities and businesses acquired <sup>(2)</sup>		-	(54)	(88)	(402)
Proceeds on disposal of controlled entities		-	-	3	35
Payments for purchase of investment property		-	-	(2)	(4)
Payments for purchase of property, plant and equipment		-	-	(61)	(82)
<b>Net cash flows from investing activities</b>		<b>(19)</b>	<b>(94)</b>	<b>(1,881)</b>	<b>(2,203)</b>
FINANCING ACTIVITIES					
Payments to controlled entities		(128)	(263)	-	-
Proceeds from issue of shares		-	-	-	-
Payments for purchase of treasury shares		(38)	-	(38)	-
Share issue expenses		(5)	(2)	(5)	(4)
Proceeds from settlement of staff share loans		-	-	47	34
Proceeds from interest bearing liabilities		-	400	731	400
Repayment of interest bearing liabilities		(400)	-	(400)	(45)
Dividends paid		(497)	(224)	(497)	(224)
<b>Net cash flows from financing activities</b>		<b>(1,068)</b>	<b>(89)</b>	<b>(162)</b>	<b>161</b>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS HELD					
		(1)	4	(4)	(55)
Cash and cash equivalents at the beginning of the financial year		14	9	1,061	1,121
Effect of exchange rate changes on opening cash and cash equivalents		-	1	(38)	(5)
<b>Cash and cash equivalents at the end of the financial year</b>		<b>13</b>	<b>14</b>	<b>1,019</b>	<b>1,061</b>

(1) Current year includes payments of \$140 million to fund defined benefit retirement obligations.

(2) Net of cash acquired.

The above statements of cash flows should be read in conjunction with the accompanying notes.

# Contents

## OF THE NOTES TO THE FINANCIAL STATEMENTS

1 Summary of significant accounting policies	75	15 Property, plant and equipment (consolidated)	96	29 Retirement benefits	125
2 Australian accounting standards and interpretations issued but not yet effective	80	16 Deferred income tax	97	30 Remuneration of auditors	129
3 Critical accounting estimates and judgments	80	17 Investment properties (consolidated)	98	31 Contingent liabilities	130
4 Insurance contracts - risk management policies and procedures	84	18 Investments in controlled entities	99	32 Capital expenditure commitments	130
5 Financial risk management	86	19 Intangible assets (consolidated)	103	33 Operating lease commitments	130
6 Revenue	89	20 Trade and other payables	105	34 Lloyd's division	131
7 Profit before income tax	89	21 Unearned premium (consolidated)	105	35 Related parties (company and consolidated)	133
8 Income tax	91	22 Outstanding claims (consolidated)	106	36 Earnings per share (consolidated)	133
9 Claims incurred (consolidated)	91	23 Provisions	108	37 Segment information	134
10 Cash and cash equivalents	92	24 Interest bearing liabilities	108	38 Reconciliation of cash flows from operating activities to net profit after income tax attributable to members of the company	137
11 Financial assets	93	25 Contributed equity	111	39 Events occurring after the balance date	137
12 Derivative financial instruments	93	26 Other reserves	113		
13 Receivables	95	27 Share based payments	114		
14 Deferred insurance costs (consolidated)	95	28 Key management personnel (company and consolidated)	119		

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial report includes separate financial statements for QBE Insurance Group Limited ("the company") as an individual entity and the consolidated entity consisting of QBE Insurance Group Limited and its controlled entities.

### (A) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian equivalents to International Financial Reporting Standards ("AIFRS"), other authoritative pronouncements of the Australian Accounting Standards Board ("AASB"), Urgent Issues Group ("UIG") Interpretations and the *Corporations Act 2001*.

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of:

- financial assets and liabilities (including derivative instruments) at fair value through the income statement;
- certain classes of property, plant and equipment; and
- investment property.

### (B) Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by the company as at 31 December 2006 and the results of all controlled entities for the financial year then ended. The company and its controlled entities together are referred to in this financial report as the "consolidated entity". The effects of all transactions between entities in the consolidated entity are eliminated in full. Minority interest in the results and equity of controlled entities is shown separately in the consolidated income statement and balance sheet.

Where control of an entity commences during a financial year, its results are included in the consolidated income statement from the date on which the control commences. Where control of an entity ceases during a financial year, its results are included for that part of the year during which the control existed.

The purchase method of accounting is used to account for the acquisition of controlled entities by the consolidated entity. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the consolidated entity's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the controlled entity acquired, the difference is recognised directly in the income statement.

### (C) Premium revenue

Premium comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable, including unclosed business, is recognised as revenue. Premium on unclosed business is brought to account based upon the pattern of booking of renewals and new business.

### (D) Unearned premium

Unearned premium is calculated based on the term of the risk which closely approximates the pattern of risks underwritten using either the daily pro-rata method or the 24ths method.

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the divisional business segment level, being a portfolio of contracts that are broadly similar and managed together as a single portfolio. If the unearned premium liability, less related intangible assets and deferred acquisition costs, is deficient, then the resulting deficiency is recognised in the income statement of the consolidated entity.

### (E) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outward reinsurance premium is treated as a prepayment at the balance date.

### (F) Claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid; claims incurred but not reported ("IBNR"); claims incurred but not enough reported ("IBNER"); and estimated claims handling costs.

The expected future payments are discounted to present value using a risk free rate.

A risk margin is applied to the central estimate, net of reinsurance and other recoveries, to reflect the inherent uncertainty in the central estimate. This risk margin increases the probability that the net liability is adequate to a minimum of 85%.

### (G) Reinsurance and other recoveries

Reinsurance and other recoveries on paid claims, reported claims not yet paid, IBNR and IBNER are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### (H) Acquisition costs

A portion of acquisition costs relating to unearned premium is deferred in recognition that it represents a future benefit. Deferred acquisition costs are measured at the lower of cost and recoverable amount. Deferred acquisition costs are amortised over the financial years expected to benefit from the expenditure.

### (I) Investment income

Interest income is recognised on an accruals basis. Dividends are recognised when due. Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

Investment income on ABC financial assets pledged for funds at Lloyd's and expenses from ABC securities for funds at Lloyd's, both of which are separately identified, include fair value gains and losses on the ABC swaps.

### (J) Taxation

The income tax expense for the period is the tax payable on the current period's taxable income based on the notional income tax rate for each jurisdiction, adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rate expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting or taxable profit or loss.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the near future.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

The company and all of its Australian wholly owned controlled entities ("Australian entities") have implemented the tax

consolidation legislation. The company is the head entity in a tax-consolidated group comprising the company and the Australian entities. All entities in the tax-consolidated group continue to account for their own current and deferred tax amounts. These tax amounts are measured as if each entity continues to be a stand-alone tax payer in its own right. In addition to its own current and deferred tax amounts, the company also recognises any current tax or deferred tax arising from unused tax losses and unused tax credits assumed from controlled entities in the tax-consolidated group. Details of the tax funding agreement are included in note 8 to the financial statements.

### (K) Cash and cash equivalents

Cash and cash equivalents includes cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used in the cash management function on a day to day basis, net of bank overdrafts.

### (L) Financial assets

#### (i) Policyholders' and shareholders' funds

Policyholders' funds are those financial assets which are held to fund the insurance provisions of the consolidated entity. The remaining financial assets, including equities, and investment properties (refer note 1(M)) represent shareholders' funds. Insurance profit is derived by adding investment income on policyholders' funds to the underwriting result.

All investments are managed and performance is evaluated on a fair value basis for both internal and external reporting in accordance with the consolidated entity's documented investment strategy.

#### (ii) Basis of valuation

All investments are designated as fair value through profit or loss on initial recognition. They are initially recorded at fair value and are subsequently remeasured to fair value at each reporting date. Fair value for each type of financial asset is determined as follows:

*Listed investments* – by reference to the closing bid price of the instrument at the balance date.

*Unlisted investments* – the fair value of financial assets not traded on an active market is determined using valuation techniques including reference to:

- the fair value of recent arm's length transactions involving the same instrument or instruments that are substantially the same;
- discounted cash flow analysis; and
- option pricing models.

All purchases and sales of financial assets that require delivery of the asset within the time frame established by regulation or market convention ("regular way" transactions) are recognised at trade date, being the date on which the consolidated entity commits to buy or sell the asset.

Financial assets are derecognised when the right to receive future cash flows from the assets has expired, or has been transferred, and the consolidated entity has transferred substantially all the risks and rewards of ownership.



## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### (M) Investment properties

Investment properties are valued by reference to external market valuations at fair value through the income statement.

### (N) Derivative financial instruments

The consolidated entity is subject to currency, cash flow, interest rate, price, credit and liquidity risks. Derivative financial instruments ("derivatives") are used to manage these risks. The consolidated entity does not enter into, issue or hold derivatives for speculative trading purposes.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged. Derivatives which are not part of a hedging relationship are valued at fair value through the income statement. Derivatives which are part of a hedging relationship are accounted for as set out in note 1(O). The fair value of forward exchange contracts is determined using forward exchange rates at the balance date.

### (O) Hedging transactions

Derivatives held for risk management purposes which meet the criteria specified in AASB 139 are accounted for by the consolidated entity using fair value hedge accounting, cash flow hedge accounting or hedging of a net investment in a foreign operation as appropriate to the risks being hedged.

When a financial instrument is designated as a hedge, the consolidated entity formally documents the relationship between the hedging instrument and hedged item as well as its risk management objectives and its strategy for undertaking the various hedging transactions. The consolidated entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used for hedging are highly effective in offsetting changes in fair values or cash flows of hedged items.

Hedge accounting is discontinued when:

- it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires, or is sold, terminated or exercised; or
- the hedged item matures, is sold or repaid.

### (i) Fair value hedge accounting

Changes in the fair value of derivatives that qualify and are designated as fair value hedges are recorded in the income statement, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the fair value hedging adjustment cumulatively made to the carrying value of the hedged item is, for items carried at amortised cost, amortised over the period to maturity of the previously designated hedge relationship using the effective interest method. If the hedged item is sold or repaid, the unamortised fair value adjustment is recognised immediately in the income statement.

### (ii) Cash flow hedge accounting

For qualifying cash flow hedges, the fair value gain or loss associated with the effective portion of the cash flow hedge is recognised initially directly in shareholders' equity and transferred to the income statement in the period when the hedged item will affect profit or loss. The gain or loss on any ineffective portion of the hedging instrument is recognised in the income statement immediately. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the hedged item affects the income statement. When a transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately transferred to the income statement.

### (iii) Hedges of net investments in foreign operations

Hedges of net investments in foreign operations, including monetary items that are accounted for as part of the net investment, are accounted for in a manner similar to cash flow hedges. The gain or loss on the effective portion of the hedging instrument is recognised directly in equity and the gain or loss on the ineffective portion is recognised immediately in the income statement. The cumulative gain or loss previously recognised in equity is recognised in the income statement on the disposal or partial disposal of the foreign operation.

### (P) Receivables

Receivables are measured at fair value through the income statement and form part of policyholders' funds.

### (Q) Property, plant and equipment

Owner occupied properties are measured at fair value by reference to external market valuations. When a revaluation increases the carrying value of a property, the increase is credited to the revaluation reserve in equity. To the extent that the increase reverses a decrease previously recognised in the income statement, the increase is first recognised in the income statement. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised in the income statement. To the extent that the decrease reverses an increase previously recognised in equity, the decrease is first recognised in equity.

All other plant and equipment is stated at historical cost less accumulated depreciation.

Leasehold improvements, office equipment, fixtures and fittings and motor vehicles are depreciated using the straight line method over the estimated useful life to the consolidated entity of each class of asset. Estimated useful lives are between three and 10 years for all classes.

An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Refer note 1(S).

### (R) Intangible assets

#### (i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the consolidated entity's share of the net identifiable assets acquired. Goodwill acquired in a business combination is tested for impairment and is not subject to amortisation.

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### (ii) Intangible assets

Intangible assets are measured at cost. Those with a finite useful life are amortised using the straight line method over the estimated useful life. Estimated useful lives are between three and 20 years. Intangible assets with an indefinite useful life are not subject to amortisation but are tested for impairment annually or more often if there is an indication of impairment.

### (S) Impairment of assets

Assets, including goodwill and intangibles, that have an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped in cash generating units which are the lowest levels for which there are separately identifiable cash flows.

### (T) Financial liabilities

Financial liabilities are initially measured at fair value and are subsequently measured at amortised cost. Any difference between the proceeds and the redemption amount is recognised in the income statement over the period of the financial liability using the effective interest method.

On issue of hybrid securities, the fair value of the liability component, being the obligation to make future payments of principal and interest to investors, is calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the fair value of the conversion option, is included in equity with no recognition of any change in the value of the option in subsequent periods. The liability is included in financial liabilities and carried on an amortised cost basis with interest on the securities recognised as financing costs on an effective interest method until the liability is extinguished on conversion or maturity of the securities.

Financial liabilities are classified as current liabilities unless the consolidated entity has an unconditional right to defer settlement of the liability for at least 12 months after the balance date.

### (U) Foreign currency translation

#### (i) Functional and presentation currency

Items included in the financial statements of controlled entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated entity's financial statements are presented in Australian dollars, being the functional and presentation currency of the company.

#### (ii) Translation of foreign currency transactions and balances

Foreign currency transactions are translated into functional currencies at the rates of exchange at the dates of the transactions. At the balance date, monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at that date. Resulting exchange gains and losses are included in the income statement.

#### (iii) Translation of overseas controlled entities

The results and balance sheets of all overseas controlled entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at the closing balance date rates of exchange;
- income and expenses are translated at cumulative average rates of exchange; and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in overseas controlled entities, and of financial liabilities and other instruments designated as hedges of such investments, are taken to shareholders' equity. When an overseas controlled entity is sold, these exchange differences are recognised in the income statement as part of the gain or loss on sale.

#### (iv) Hedging transactions

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to note 1(O).

### (V) Equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of new shares or options, or for the acquisition of a business, are included in the cost of acquisition as part of the purchase consideration.

The equity component of hybrid securities is calculated and disclosed as set out in note 1(T).

### (W) Earnings per share

#### (i) Basic earnings per share

Basic earnings per share is determined by dividing net profit after income tax attributable to members of the company, adjusted for the cost of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

#### (ii) Diluted earnings per share

Diluted earnings per share adjusts the earnings figure used in the determination of basic earnings per share to exclude the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration. It also adjusts the weighted average number of shares to include dilutive potential ordinary shares and instruments with a mandatory conversion feature.

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### (X) Dividends

Dividends are recognised when appropriately authorised and no longer at the discretion of the entity, on or before the end of the financial year but not distributed at the balance date.

### (Y) Employee benefits

#### (i) Superannuation

The consolidated entity participates in a number of superannuation plans and contributes to these plans in accordance with plan rules and actuarial recommendations, which are designed to ensure that each plan's funding provides sufficient assets to meet its liabilities.

#### Defined contribution plans

For defined contribution plans, contributions are expensed as incurred.

#### Defined benefit plans

The liability recognised in the balance sheet in respect of defined benefit superannuation plans is the present value of the defined benefit obligation at the balance date less the fair value of plan assets, adjusted for any unrecognised past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate or government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating the term of the related superannuation liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised directly in equity. Past service costs are recognised immediately in income, unless the changes to the superannuation plan are conditional on the employees remaining in service for a specified period of time (the vesting period) in which case the past service costs are amortised on a straight line basis over the vesting period.

#### (ii) Share based payment

The consolidated entity operates an equity settled, share based compensation plan. No expense is recognised for options and conditional rights granted before 7 November 2002 and/or vested before 1 January 2005. For all other options and conditional rights, the fair value of the employee services received in exchange for the grant of those instruments is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted, excluding the impact of any non-market vesting conditions. The fair value at grant date of the options and conditional rights is calculated using a binomial model. The fair value of each instrument is expensed evenly over the period between grant and vesting dates. Non-market vesting conditions are included in assumptions about the number of instruments that are expected to become exercisable. At each balance date, the consolidated entity revises its estimates of the number of options that are expected to become exercisable.

The consolidated entity recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

#### (iii) Profit sharing and bonus plans

The consolidated entity recognises a liability and an expense for bonuses and profit sharing, based on a formula that takes into consideration the profit attributable to the company's shareholders after certain adjustments.

#### (iv) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date or when an employee accepts voluntary redundancy in exchange for these benefits. The consolidated entity recognises termination benefits when it has demonstrably committed to either:

- terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or
- providing termination benefits as a result of an offer made to encourage voluntary redundancy.

#### (v) Long service leave

The provision for long service leave is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method.

Benefits falling due more than 12 months after the balance date are discounted to present value.

### (Z) Treasury shares held in trust

The assets, liabilities and results of share based remuneration trusts are included in the balance sheet and results of the consolidated entity. These trusts may hold shares in the company to satisfy the company's obligations under the Employee Share and Option Plan ("the Plan"). Any shares in the company held by a trust are measured at cost (including any attributable acquisition costs). No gain or loss is recognised in the income statement on the sale, cancellation or reissue of these shares. On consolidation, these shares are presented on the balance sheet as treasury shares held in trust and represent a reduction in equity.

### (AA) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight line basis over the period of the lease.

### (AB) Rounding of amounts

The company is of a kind referred to in the ASIC class order 98/0100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the financial statements. Amounts have been rounded off in the financial statements to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with that class order.

# 2

## AUSTRALIAN ACCOUNTING STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

	<b>TITLE</b>	<b>OPERATIVE DATE</b>
2005-10	Amendments to Australian Accounting Standards (AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 and AASB 1038)	1 January 2007
AASB 7	Financial Instruments: Disclosures	1 January 2007
UIG 8	Scope of AASB 2	1 January 2007
UIG 9	Reassessment of Embedded Derivatives	1 January 2007
UIG 10	Interim Reporting and Impairment	1 January 2007
AASB 101	Presentation of Financial Statements (revised October 2006)	1 January 2007

These amendments are not effective for the year ended 31 December 2006 and have not been applied in preparing the consolidated entity's and the company's financial statements. The application of these standards is not expected to have a material impact on the consolidated entity's or the company's financial statements.

The consolidated entity and the company will apply these standards for the annual reporting period beginning on the operative date set out above.

# 3

## CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The consolidated entity is an international general insurance and reinsurance group underwriting most major commercial and personal lines classes of business through operations in 44 countries. The class of business mix and an analysis of the consolidated entity's gross written and net earned premium from insurance and reinsurance business is shown on page 15. The head office function is located in Australia and exists to support the activities of divisional operations as follows:

- Australia Pacific Asia Central Europe ("APACE"), which comprises general insurance operations in 26 countries under a single management structure;
- European operations, which comprises reinsurance business written in the UK and Ireland, general insurance business written in the UK and throughout mainland Europe, and both general insurance and reinsurance business written through Lloyd's of London; and
- QBE the Americas, which comprises general insurance and reinsurance operations in the US and a number of Latin American countries.

In view of this geographic and product diversity, the consolidated entity has developed a strong, centralised risk management and policy framework designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of the claims provision and investment management. In addition, the assessment of the risk margin undertaken at a divisional level is subject to detailed head office review and the consolidated entity's probability of adequacy is determined by the chief actuarial officer.

Given the centralised approach to many of its activities and the product and geographical diversification, sensitivity analyses in respect of critical accounting estimates and judgments are presented at the consolidated entity level in order to provide a level of analysis which is meaningful, relevant, reliable and comparable year on year. It is considered that disclosure at business segment or product level would not provide a meaningful overview given the complex interrelationships between the variables underpinning the consolidated entity's operations.

The consolidated entity makes estimates in respect of certain key assets and liabilities. Such estimates are determined by qualified and experienced employees with reference to historical data and reasoned expectations of future events. The key areas in which critical estimates and judgments are applied are described below.

### (A) Ultimate liability arising from claims made under insurance contracts

Provision is made for the estimated cost of claims incurred but not settled at the balance date. The estimated cost of claims includes direct expenses that are expected to be incurred in settling those claims.

## CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS CONTINUED

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the consolidated entity, where more information about the claims is generally available. Liability and other long tail classes of business, where claims settlement may not happen for many years after the event giving rise to the claim, typically display greater variability between initial estimates and final settlement due to delays in reporting claims, uncertainty in respect of court awards and future claims inflation. Claims in respect of property and other short tail classes are typically reported and settled sooner after the claim event, giving rise to more certainty. The estimation techniques and assumptions used in determining the outstanding claims provision and the associated reinsurance and other recoveries are described below.

### (i) Insurance risk assumptions

The consolidated entity's process for establishing the outstanding claims provision involves extensive consultation with internal and external actuaries, claims managers, underwriters and other senior management. This process includes quarterly internal claims review meetings attended by senior divisional and Group management and detailed review by external actuaries at least annually. The risk management procedures related to the actuarial function are explained further in note 4.

The determination of the amounts that the consolidated entity will ultimately pay for claims arising under insurance and reinsurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs for long tail insurance classes due to the longer period of time that elapses before a definitive determination of the ultimate claims cost can be made;
- incidence of catastrophic events close to the balance date;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example price and wage inflation and interest rates.

The potential impact of changes in key assumptions on the consolidated entity's income statement and balance sheet are summarised in note 3(A)(vii).

### (ii) Central estimates

The outstanding claims provision comprises the central estimate and a risk margin which is added to the central estimate to achieve a desired probability of adequacy. The outstanding claims provision is discounted at risk free rates of return to reflect the time value of money.

A central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation. As the consolidated entity requires a higher probability that estimates will be adequate over time, a risk margin is added to the central estimate of outstanding claims.

Central estimates for each class of business are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimates are based on a judgmental consideration of the results of each method and qualitative information, for example, the class of business, the maturity of the portfolio and the expected term to settlement of the class. Projections are based on both historical experience and external benchmarks where relevant.

Central estimates are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts recoverable from reinsurers based on the gross outstanding claims provision.

### (iii) Risk margin

The determination of the appropriate level of risk margin takes into account the uncertainty or variability of each class of business and the diversification benefits achieved by writing a number of classes of business in a number of geographic locations.

The measurement of variability by class of business uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. The use of a range of outcomes allows a determination of the risk margin required to provide an estimate at a given probability of adequacy, e.g. nine times in 10 (a 90% probability of adequacy). These techniques use standard statistical distributions, and the measure of variability is referred to as the standard deviation or the coefficient of variation.

The risk margin required to provide a given probability of adequacy for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. The statistical measure used to determine diversification is called the correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. For example, high correlation exists in classes of business affected by court cases involving bodily injury claims such as motor third party liability (CTP), workers' compensation and public liability.

## CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS CONTINUED

Whilst there are estimation techniques for determining correlations, they are difficult to apply. The correlations adopted by the consolidated entity are normally derived from industry analysis, the consolidated entity's historical experience and the judgment of experienced and qualified actuaries.

The risk margin for the consolidated entity is determined by analysing the variability of each class of business and the correlation between classes of business and divisions. Correlations are determined for aggregations of classes of business, where appropriate, at the divisional level. Applying correlations between divisions results in a further diversification benefit to the consolidated entity with a consequent impact on the consolidated entity's risk margin.

The potential impact of changes in the coefficient of variation assumptions on the consolidated entity's income statement and balance sheet is summarised in note 3(A)(vii).

(iv) Assets arising from contracts with reinsurers

Assets arising from contracts with the consolidated entity's reinsurers are determined using the same methods described above. In addition, the recoverability of these assets is assessed at each balance date to ensure that the balances properly reflect the amounts that will ultimately be received, taking into account counterparty and credit risk.

(v) Expected present value of future cash flows for future claims

The expected present value of future cash flows for future claims and risk margin used in the liability adequacy test are determined using the same methods described above.

(vi) Financial assumptions used to determine outstanding claims provisions

The outstanding claims provision is discounted to net present value using a risk free rate of return. Details of risk free rates applied are as follows:

	2006 %		2005 %	
	SUCCEEDING YEAR	SUBSEQUENT YEARS	SUCCEEDING YEAR	SUBSEQUENT YEARS
Australia Pacific Asia Central Europe	2.97 – 12.75	2.97 – 12.75	2.70 – 13.40	2.70 – 13.40
European operations	4.80 – 5.10	4.80 – 5.10	4.30 – 4.40	4.30 – 4.40
the Americas	4.80	4.80	4.40	4.40
Equator Re	4.80 – 6.35	4.80 – 6.35	4.30 – 5.53	4.30 – 5.38

The potential impact of a change in discount rates on the consolidated entity's income statement and balance sheet is summarised in note 3(A)(vii).

The weighted average terms to settlement of net outstanding claims at the balance date are as follows:

	2006 YEARS	2005 YEARS
Australia Pacific Asia Central Europe	2.6	2.8
European operations	2.9	3.0
the Americas	2.2	2.2
Equator Re	2.3	1.9
Consolidated entity	2.8	2.9

The potential impact of a change in the weighted average term to settlement on the consolidated entity's income statement and balance sheet is summarised in note 3(A)(vii).

The consolidated entity's exposure to interest rate risk in respect of financial assets is also considered in note 5(A)(ii).

(vii) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key outstanding claims variables are summarised in the table on page 83. Each change has been calculated in isolation of the other changes and each change shows the after tax impact on profit and equity assuming that there is no change to:

- Any of the other variables – This is considered unlikely as, for example, an increase in interest rates is normally accompanied by an increase in the rate of inflation. As can be seen from the table on page 83, the impact of a change in discount rates is largely offset by the impact of a change in the rate of inflation. The impact of a change in interest rates on financial assets is shown in note 5(D).

## CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS CONTINUED

- The probability of adequacy – The directors and management have set an internal target range of 85% to 94% for the probability of adequacy of the outstanding claims provision. It is likely that if, for example, the central estimate was to increase by 5%, at least part of the increase would result in a decrease in the probability of adequacy, which is currently estimated to be 94.6%. Likewise, if the coefficient of variation were to increase by 1%, it is likely that the probability of adequacy would reduce from its current level and that the change would therefore impact the amount of risk margins held rather than net profit after income tax or equity.

	MOVEMENT IN VARIABLE %	FINANCIAL IMPACT <sup>(1)</sup>	
		PROFIT (LOSS) \$M	EQUITY \$M
Central estimate	+5	(359)	(359)
	-5	359	359
Inflation rate	+1	(207)	(207)
	-1	198	198
Discount rate	+1	209	209
	-1	(224)	(224)
Coefficient of variation	+1	(122)	(122)
	-1	123	123
Weighted average term to settlement	+10	113	113
	-10	(122)	(122)

(1) Determined at the consolidated entity level net of reinsurance and taxation at the prima facie rate of 30%.

**(B) Retirement benefit obligations**

The present value of the obligations arising from the consolidated entity's defined benefit superannuation plans is determined by external actuaries based on discount rate, mortality, salary growth and investment return assumptions. Key assumptions are set out in note 29.

The discount rate applied to the various plans is the interest rate on high quality corporate bonds (where there is a sufficiently deep market) or the appropriate government bond rate. The surplus or deficit at each balance date varies to reflect changes in interest rates.

Mortality assumptions are affected by experience which indicates increasing longevity, particularly for certain age groups of the population. The consolidated entity has considered the consensus of professional opinions from a number of external actuaries in respect of the appropriateness of the mortality tables selected for use in the valuation of the superannuation obligations for each of the consolidated entity's plans.

The potential impact of a change in the most sensitive assumption on the consolidated entity's income statement and balance sheet is summarised below.

	MOVEMENT IN VARIABLE %	FINANCIAL IMPACT <sup>(1)</sup>	
		PROFIT (LOSS) \$M	EQUITY \$M
Discount rate	+1	–	79
	-1	–	(99)

(1) Determined at the consolidated entity level net of taxation at the prima facie rate relevant to the superannuation plan.

**(C) Intangible assets**

Goodwill and intangible assets with an indefinite useful life are tested annually for impairment, or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The impairment review is based on the net present value of estimated future cash flows of the relevant cash generating unit, which is determined by reference to, amongst other factors, the estimated combined operating ratio in the business plan.

If the combined operating ratio applied in these calculations was increased by one per cent over management's estimates at 31 December 2006, the consolidated entity would have no requirement to reflect an impairment write down.

## INSURANCE CONTRACTS – RISK MANAGEMENT POLICIES AND PROCEDURES

An overview of the consolidated entity's risk management framework is provided in the risk management statement on pages 18 and 19 and in the risk management section of the corporate governance statement on pages 49 to 50. The consolidated entity's risk management objectives are to:

- avoid unwelcome surprises by reducing uncertainty and volatility;
- achieve competitive advantage through better understanding the risk environment in which the consolidated entity operates; and
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward.

A fundamental part of the consolidated entity's overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows arising from insurance contracts. These risks include insurance and reinsurance risks, financial risks and other risks such as regulatory and capital risks.

One of the cornerstones of the consolidated entity's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices. The consolidated entity operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored.

### (A) Insurance and reinsurance risks

The consolidated entity has established protocols to manage its insurance risks across the underwriting, claims and actuarial disciplines.

#### (i) Underwriting risks

##### Selection and pricing of risks

Underwriting authority is delegated to experienced underwriters for the forthcoming year following a detailed retrospective and prospective analysis of each class of business as part of the consolidated entity's annual business planning process. Delegated authorities reflect the level of risk which the consolidated entity is prepared to take. The authorities include reference to some combination of:

- gross written premium;
- premium per contract;
- sum insured per contract;
- aggregate exposures per zone;
- probable maximum loss and realistic disaster scenarios ("RDSs");
- levels and quality of reinsurance protection;
- geographic exposures; and/or
- classes of business and types of product that may be written.

Limits in respect of each of the above are set at a portfolio, divisional and consolidated entity level and are included within business plans for individual classes of business. They are adjusted at a local level to reflect a risk factor in respect of each controlled entity depending on previous underwriting results, the economic environment and other potential drivers of volatility.

Insurance and reinsurance policies are written in accordance with local management practices and regulations within each jurisdiction taking into account the consolidated entity's risk tolerance and underwriting standards. Non-standard and long term policies may only be written if expressly included in the delegated authorities. No individual long term or non-standard policy is material to the consolidated entity.

Pricing of risks is controlled by use of in-house pricing models relevant to the specific portfolio and markets in which the consolidated entity operates. Experienced underwriters and actuaries maintain historical pricing and claims analysis for each portfolio and this is combined with a detailed knowledge of the current developments in the respective markets and classes of business.

##### Concentration risk

The consolidated entity's exposure to concentrations of insurance risk is mitigated by a portfolio diversified across 44 countries and hundreds of classes of business. Product diversification is achieved through a strategy of developing strong underwriting skills in a wide variety of classes of business. A combination of core and specialty products under the control of proven employees skilled in underwriting such products allows the consolidated entity to lead underwrite in many of the markets in which it operates.



## INSURANCE CONTRACTS – RISK MANAGEMENT POLICIES AND PROCEDURES CONTINUED

The consolidated entity has potential exposure to catastrophe losses that may impact more than one operating division. Each year, the consolidated entity sets its tolerance to concentration risk. RDSs, using industry standard and QBE determined probable maximum losses and various catastrophe models, are calculated for each portfolio during the business planning process. These RDSs are aggregated across all portfolios and divisions to determine the consolidated entity's maximum event retention ("MER") which is the estimated maximum net loss from major natural catastrophes with an approximate return period of 250 years. The MER must be less than the consolidated entity's concentration risk tolerance, otherwise steps such as the purchase of additional reinsurance are taken to limit the exposure.

In 2006, the net cost to the consolidated entity of catastrophic events above \$2.5 million was \$251 million before tax (2005 \$554 million before tax).

### Reinsurance risk

The consolidated entity's strategy in respect of the selection, approval and monitoring of reinsurance arrangements is addressed by the following protocols:

- treaty or facultative reinsurance is placed in accordance with the requirements of the consolidated entity's reinsurance management strategy and Group security committee guidelines; and
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historic losses and potential future losses based on RDSs and the consolidated entity's MER.

The consolidated entity's exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

### (ii) Claims management and claims provisioning risks

The consolidated entity's approach to determining the outstanding claims provision and the related sensitivities are set out in note 3. The consolidated entity seeks to ensure the adequacy of its outstanding claims provision by reference to the following controls:

- Experienced claims managers work with underwriters on coverage issues and operate within the levels of authority delegated to them in respect of the settlement of claims.
- Processes exist to ensure that all claims advices are captured and updated on a timely basis and with a realistic assessment of the ultimate claims cost.
- Initial IBNR estimates are set by experienced internal actuaries in conjunction with the local product managers and underwriters for each class of business in each business unit.
- The aggregate outstanding claims provision for each controlled entity is assessed in a series of quarterly internal claims review meetings, which are attended by senior divisional management and one or both of the chief risk officer and Group chief actuarial officer in order to ensure consistency of provisioning practices across all divisions.
- Approximately 90% of the consolidated entity's outstanding claims provision is reviewed by external actuaries at least annually.

Despite the rigour involved in the establishment and review of the outstanding claims provision, the provision is subject to significant uncertainty for the reasons set out in note 3.

### (B) Financial risks arising from insurance contracts

The consolidated entity is exposed to the risk that interest rate movements may materially impact the value of the outstanding claims provision. Historically, there has been a high correlation between changes in discount rates and the movement in claims inflation. The financial impact of changing interest rates on outstanding claims is therefore expected to be offset in the longer term by similar changes in claims inflation.

### (C) Other risks arising from insurance contracts

The consolidated entity is exposed to a number of other risks arising from insurance contracts.

#### (i) Capital and regulatory risks

Australian and overseas controlled entities are subject to extensive prudential regulation in the jurisdictions in which they conduct business. Prudential regulation is generally designed to protect policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations. The regulatory environment in Australia and overseas continues to evolve in response to economic, political and industry developments. The consolidated entity works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements.

#### (ii) Acquisition risks

The consolidated entity's strategy of growth by acquisition exposes it to additional risks. Acquisition risks are principally managed by the consolidated entity's controls over the due diligence and subsequent integration processes. The consolidated entity has experienced due diligence teams in each of the divisions and has documented minimum requirements for carrying out due diligence.

## FINANCIAL RISK MANAGEMENT

The activities of the consolidated entity expose it to financial risks such as market risk (including currency risk, cash flow and fair value interest rate risk and price risk), credit risk and liquidity risk. The consolidated entity's risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group.

The key objectives of the consolidated entity's asset and liability management strategy are to ensure sufficient liquidity is maintained at all times to meet the consolidated entity's obligations, including its settlement of insurance liabilities and, within these parameters, to optimise investment returns for policyholders and shareholders.

### (A) Market risk

#### (i) Currency risk

The consolidated entity is exposed to foreign currency risk in respect of its net foreign currency exposures. This risk is managed as follows.

- Each controlled entity manages the volatility arising from changes in foreign exchange rates by matching liabilities with assets of the same currency, thus ensuring that any exposures to overseas currencies are minimised.
- Forward foreign exchange contracts are used to protect residual currency positions. These forward foreign exchange contracts are accounted for in accordance with the derivatives accounting policy set out in note 1(N).
- The consolidated entity manages the foreign currency exposures arising from the revaluation of net investments in foreign operations to Australian dollars using either foreign currency interest bearing liabilities designated as hedging instruments or forward foreign exchange contracts designated as hedging instruments.

Those arrangements which meet the hedging criteria set out under AASB 139 are accounted for in accordance with the accounting policy set out in note 1(O). The effectiveness of the currency management processes and the related use of derivatives is actively monitored by the Group treasurer and Group chief financial officer.

The risk management process covering forward foreign exchange contracts and hedges involves close senior management scrutiny, including regular board and other management reporting. All forward foreign exchange contracts and hedge transactions are subject to delegated authority levels provided to management, and the levels of exposure are reviewed on an ongoing basis.

All instruments that are designated as hedges are tested for effectiveness on both a prospective and retrospective basis. These tests are performed at least quarterly.

#### (ii) Cash flow and fair value interest rate risk

The consolidated entity is exposed to interest rate risk arising on interest bearing assets. Assets with floating rate interest expose the consolidated entity to cash flow interest rate risk. Fixed interest rate assets expose the consolidated entity to fair value interest rate risk. The consolidated entity's strategy is to invest in high quality, liquid fixed interest securities and cash and to actively manage duration. The investment portfolios are actively managed to achieve a balance between cash flow interest rate risk and fair value interest rate risk bearing in mind the need to meet the liquidity requirements of the insurance business.

The consolidated entity is also exposed to interest rate risk arising from long term interest bearing liabilities.

Eurobonds issued at variable interest rates expose the consolidated entity to cash flow interest rate and foreign currency risk. The consolidated entity manages this cash flow interest rate risk by using floating to fixed cross currency interest rate swaps, details of which are set out in note 24.

The consolidated entity is exposed to fair value interest rate and currency risk in respect of ABC securities and is exposed to cash flow interest rate risk on the ABC financial assets pledged. The consolidated entity manages these risks by using floating to fixed interest rate swaps and floating to fixed cross currency interest rate swaps, details of which are set out in note 34.

Other long term interest bearing liabilities are mainly fixed interest rate borrowings valued at amortised cost and therefore do not expose the entity to cash flow or fair value interest rate risk.

The consolidated entity's exposure to interest rate risk and the effective weighted average interest rate for each significant class of interest bearing financial asset and liability is provided on the opposite page.

## FINANCIAL RISK MANAGEMENT CONTINUED

		FIXED INTEREST RATE MATURING IN							
2006		FLOATING INTEREST RATE	1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
<b>(i) Net interest bearing financial assets (excluding ABC financial assets and ABC securities)</b>									
Interest bearing securities	\$M	2,353	12,957	1,057	428	32	44	303	17,174
Weighted average interest rate	%	4.8	5.1	5.3	5.1	6.3	6.7	6.6	5.1
Financial liabilities	\$M	—	(77)	—	(433)	—	—	(1,854)	(2,364)
Weighted average interest rate	%	—	3.2	—	5.6	—	—	5.9	5.8
<b>Net interest bearing financial assets</b>	<b>\$M</b>	<b>2,353</b>	<b>12,880</b>	<b>1,057</b>	<b>(5)</b>	<b>32</b>	<b>44</b>	<b>(1,551)</b>	<b>14,810</b>
<b>(ii) ABC financial assets and ABC securities</b>									
ABC financial assets pledged for funds at Lloyd's	\$M	—	—	696	299	—	—	—	995
Weighted average interest rate <sup>(1)</sup>	%	—	—	3.3	3.0	—	—	—	3.2
ABC securities for funds at Lloyd's	\$M	—	—	(671)	(275)	—	—	—	(946)
Weighted average interest rate	%	—	—	4.8	4.7	—	—	—	4.8
<b>Net ABC financial assets and ABC securities</b>	<b>\$M</b>	<b>—</b>	<b>—</b>	<b>25</b>	<b>24</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>49</b>

(1) Weighted average interest rate is net of swap income.

		FIXED INTEREST RATE MATURING IN							
2005		FLOATING INTEREST RATE	1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
(i) Net interest bearing financial assets (excluding ABC financial assets and ABC securities)									
Interest bearing securities	\$M	3,100	9,376	1,803	526	217	360	447	15,829
Weighted average interest rate	%	4.3	4.7	4.8	5.0	5.4	5.5	5.8	4.7
Financial liabilities	\$M	(400)	—	—	—	(404)	(344)	(982)	(2,130)
Weighted average interest rate	%	5.8	—	—	—	5.7	8.8	3.4	5.2
Net interest bearing financial assets	\$M	2,700	9,376	1,803	526	(187)	16	(535)	13,699
(ii) ABC financial assets and ABC securities									
ABC financial assets pledged for funds at Lloyd's	\$M	—	—	—	750	282	—	—	1,032
Weighted average interest rate <sup>(1)</sup>	%	—	—	—	3.4	3.3	—	—	3.4
ABC securities for funds at Lloyd's	\$M	—	—	—	(720)	(295)	—	—	(1,015)
Weighted average interest rate	%	—	—	—	4.8	4.7	—	—	4.8
Net ABC financial assets and ABC securities	\$M	—	—	—	30	(13)	—	—	17

(1) Weighted average interest rate is net of swap income.

## FINANCIAL RISK MANAGEMENT CONTINUED

	2006 \$M	2005 \$M
<b>(iii) Reconciliation of net financial assets to net assets</b>		
Net financial assets		
Interest bearing	14,810	13,699
ABC financial assets pledged for funds at Lloyd's	995	1,032
ABC securities for funds at Lloyd's	(946)	(1,015)
Non-interest bearing and other	1,390	1,401
Net insurance liabilities	(12,031)	(11,267)
Net non-financial assets	2,131	1,309
<b>Net assets</b>	<b>6,349</b>	<b>5,159</b>

The potential impact of movements in interest rates on the consolidated entity's income statement and balance sheet in relation to the valuation of financial assets is summarised in note 5(D).

**(iii) Price risk**

The consolidated entity is exposed to price or market value risk on its investment in equities and fixed interest securities and uses forward contracts and options to manage this exposure. The risk management processes over these forward contracts and options are the same as those explained in note 5(A)(i) in respect of forward foreign currency contracts.

Equities are held mainly against shareholders' funds. At 31 December 2006, 8.6% (2005 3.6%) of the consolidated entity's financial assets and cash were held in listed equities. The potential impact of movements in the market value of equities on the consolidated entity's income statement and balance sheet is shown in note 5(D).

**(B) Credit risk**

Credit risk exposures are calculated regularly and compared with authorised credit limits before further transactions are undertaken with each counterparty.

92% (2005 77%) of total fixed interest and cash is with counterparties having a Moody's rating of Aa3 or better. The consolidated entity does not expect any investment counterparties to fail to meet their obligations given their strong credit ratings and therefore does not require collateral or other security to support derivatives. The consolidated entity only uses derivatives in highly liquid markets.

**(C) Liquidity risk**

In addition to treasury cash held for working capital requirements, a minimum percentage of the consolidated entity's total financial assets is held in liquid, short term money market securities to ensure there are sufficient liquid funds available to meet obligations. Details of the consolidated entity's financial assets are provided in note 11. At 31 December 2006, the mean term of cash and fixed interest investments was 0.4 years (2005 0.6 years).

The consolidated entity limits the risk of liquidity shortfalls resulting from a mismatch in the timing of claims payments and receipt of claims recoveries by negotiating cash call clauses in reinsurance contracts and seeking accelerated settlements for large claims.

**(D) Impact of changes in key variables**

	MOVEMENT IN VARIABLE %	FINANCIAL IMPACT <sup>(1)</sup>	
		PROFIT (LOSS) \$M	EQUITY \$M
Interest rate movement – impact on fair value of fixed interest securities	+1	(50)	(50)
	-1	54	54
Market value of equities	+1	12	12
	-1	(12)	(12)

(1) Determined at the consolidated entity level net of taxation at the prima facie rate of 30%.

## REVENUE

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Premium revenue</b>				
Direct and facultative	-	-	8,601	7,606
Inward reinsurance	-	-	1,468	1,565
	-	-	10,069	9,171
<b>Other revenue</b>				
Reinsurance and other recoveries	-	-	977	2,327
Interest and dividend income	2,352	520	773	616
Foreign exchange gains	-	-	18	3
	2,352	520	1,768	2,946
Net fair value gains on financial assets	2	-	207	217
Net fair value gains on investment properties	-	-	6	(1)
Realised gain (loss) on sale of controlled entities	16	629	(1)	11
Investment income – ABC financial assets pledged for funds at Lloyd's	30	48	122	84
<b>Revenue</b>	<b>2,400</b>	<b>1,197</b>	<b>12,171</b>	<b>12,428</b>

## 7

## PROFIT BEFORE INCOME TAX

(A) Profit before income tax (consolidated)

	NOTE	2006 \$M	2005 \$M
Gross written premium		10,372	9,408
Unearned premium movement		(303)	(237)
Gross earned premium		10,069	9,171
Outward reinsurance premium		(1,842)	(1,785)
Deferred reinsurance premium movement		(69)	-
Outward reinsurance premium expense		(1,911)	(1,785)
Net earned premium		8,158	7,386
Gross claims incurred		(5,528)	(6,744)
Reinsurance and other recoveries		977	2,327
Net claims incurred	9	(4,551)	(4,417)
Net commission		(1,384)	(1,251)
Other acquisition costs		(498)	(428)
Underwriting and other expenses		(525)	(482)
		(6,958)	(6,578)
<b>Underwriting profit</b>		<b>1,200</b>	<b>808</b>
Investment income on policyholders' funds		588	480
<b>Insurance profit</b>		<b>1,788</b>	<b>1,288</b>
Investment income on shareholders' funds		234	238
Amortisation of intangibles and impairment of goodwill/intangibles		(10)	(3)
<b>Profit before income tax</b>		<b>2,012</b>	<b>1,523</b>

## PROFIT BEFORE INCOME TAX CONTINUED

## (B) Net investment and other income

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Dividends from controlled entities	2,275	445	-	-
Dividends from non-related entities	-	-	47	41
Interest received or receivable from controlled entities	70	65	-	-
Interest received or receivable from non-related entities	3	1	719	567
Other investment income	4	9	7	8
<b>Interest and dividend income</b>	<b>2,352</b>	<b>520</b>	<b>773</b>	<b>616</b>
Investment income – ABC financial assets pledged for funds at Lloyd's	30	48	122	84
Net realised (losses) gains – equities and investment properties	-	-	(13)	94
Net realised gains – fixed interest and other	2	-	60	61
Net unrealised gains – equities and investment properties	-	-	123	35
Net unrealised gains – fixed interest and other	-	-	43	26
Realised gains on sale of controlled entities	16	629	-	11
Foreign exchange gains	-	-	18	3
<b>Investment and other income</b>	<b>2,400</b>	<b>1,197</b>	<b>1,126</b>	<b>930</b>
Expenses – ABC securities for funds at Lloyd's	(59)	(45)	(143)	(101)
Finance costs paid or payable to controlled entities	(19)	(49)	-	-
Finance costs paid or payable to non-related entities	(55)	(44)	(128)	(96)
Investment expenses	(4)	(1)	(32)	(15)
Realised loss on sale of controlled entity	-	-	(1)	-
Foreign exchange losses	(12)	(5)	-	-
<b>Net investment and other income</b>	<b>2,251</b>	<b>1,053</b>	<b>822</b>	<b>718</b>
Investment income on policyholders' funds			588	480
Investment income on shareholders' funds			234	238
<b>Net investment and other income</b>			<b>822</b>	<b>718</b>

## (C) Other expenses

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Net commission	-	-	1,384	1,251
Other acquisition costs	-	-	498	428
Underwriting and other expenses	-	-	525	482
Investment expenses	4	1	32	15
Amortisation and impairment of goodwill/intangibles	-	-	10	3
Foreign exchange losses	12	5	-	-
<b>Other expenses</b>	<b>16</b>	<b>6</b>	<b>2,449</b>	<b>2,179</b>

## (D) Specific items

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Defined contribution superannuation plan expense	-	-	32	24
Payments on operating leases	-	-	79	33
Depreciation of assets	-	-	42	40

## INCOME TAX

## (A) Reconciliation of prima facie tax to income tax expense

	NOTE	THE COMPANY		CONSOLIDATED	
		2006 \$M	2005 \$M	2006 \$M	2005 \$M
Profit before income tax		2,251	1,053	2,012	1,523
Prima facie tax payable at 30%		675	316	604	457
Tax effect of permanent differences:					
Untaxed dividends		(687)	(335)	(11)	(11)
Differences in tax rates		4	15	(55)	(1)
Other, including non-allowable expenses and non-taxable income		(11)	(2)	(8)	(20)
Prima facie tax adjusted for permanent differences		(19)	(6)	530	425
Prior year tax losses not previously recognised		(3)	-	(3)	-
Additions		-	(12)	-	-
(Overprovision) underprovision in prior years		(6)	11	(8)	-
<b>Income tax (revenue) expense</b>		<b>(28)</b>	<b>(7)</b>	<b>519</b>	<b>425</b>
Analysed as follows:					
Current tax		(7)	(15)	423	262
Deferred tax		(15)	(3)	104	163
(Overprovision) underprovision in prior years		(6)	11	(8)	-
		<b>(28)</b>	<b>(7)</b>	<b>519</b>	<b>425</b>
Deferred tax (revenue) expense comprises:					
Deferred tax assets (credited) charged to income statement	16	(7)	(3)	68	(38)
Deferred tax liabilities (credited) charged to income statement	16	(8)	-	36	201
		<b>(15)</b>	<b>(3)</b>	<b>104</b>	<b>163</b>

## (B) Tax consolidation legislation

The accounting policy in relation to this legislation is set out in note 1(J).

On adoption of the tax consolidation legislation, the directors of the company and its Australian entities entered into a tax sharing and tax funding agreement that requires the Australian entities to fully compensate the company for current tax liabilities and to be fully compensated by the company for any current tax or deferred tax assets in respect of tax losses arising from external transactions occurring after the date of implementation of the tax consolidation legislation. The contributions are allocated by reference to the notional taxable income of each Australian entity.

Details of franking credits available to shareholders are shown in note 25(E).

## CLAIMS INCURRED (CONSOLIDATED)

## (A) Claims analysis

	2006 \$M	2005 \$M
<b>Gross claims incurred and related expenses</b>		
Direct and facultative	4,773	4,936
Inward reinsurance	755	1,808
	5,528	6,744
<b>Reinsurance and other recoveries</b>		
Direct and facultative	833	1,408
Inward reinsurance	144	919
	977	2,327
<b>Net claims incurred</b>	<b>4,551</b>	<b>4,417</b>

## CLAIMS INCURRED (CONSOLIDATED) CONTINUED

## (B) Claims development

Current year claims relate to risks borne in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all previous reporting years.

	2006			2005		
	CURRENT YEAR \$M	PRIOR YEARS \$M	TOTAL \$M	CURRENT YEAR \$M	PRIOR YEARS \$M	TOTAL \$M
<b>Gross claims incurred and related expenses</b>						
Undiscounted	6,102	(284)	5,818	7,533	(651)	6,882
Discount	(543)	253	(290)	(659)	521	(138)
	5,559	(31)	5,528	6,874	(130)	6,744
<b>Reinsurance and other recoveries</b>						
Undiscounted	760	244	1,004	2,458	(33)	2,425
Discount	(58)	31	(27)	(233)	135	(98)
	702	275	977	2,225	102	2,327
<b>Net claims incurred</b>						
Undiscounted	5,342	(528)	4,814	5,075	(618)	4,457
Discount	(485)	222	(263)	(426)	386	(40)
	4,857	(306)	4,551	4,649	(232)	4,417

The development of net undiscounted outstanding claims for the six most recent accident years is shown in note 22.

## 10

## CASH AND CASH EQUIVALENTS

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Cash at bank and in hand	13	12	274	317
Overnight money	-	2	179	162
Cash management trusts	-	-	242	129
Term deposits	-	-	324	416
Commercial paper	-	-	-	37
	13	14	1,019	1,061

Included in cash and cash equivalents are amounts totalling \$20 million (2005 \$31 million) not available for use by the consolidated entity which are held within Lloyd's syndicates as funds at Lloyd's.



## FINANCIAL ASSETS

(A) Financial assets at fair value through the income statement

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Short term money	62	40	10,040	8,292
Government bonds	-	-	5,011	3,866
Corporate bonds	-	-	911	1,919
Floating rate notes and other	-	-	1,099	1,634
Fixed interest trusts	-	-	104	68
Mortgages	-	-	9	50
	62	40	17,174	15,829
<b>Equities</b>				
Listed	-	-	1,729	654
Unlisted	-	-	28	33
Equity derivatives	-	-	(16)	(13)
	-	-	1,741	674
	62	40	18,915	16,503
Amounts maturing within 12 months	62	40	13,895	11,133
Amounts maturing in greater than 12 months	-	-	5,020	5,370
	62	40	18,915	16,503

ABC financial assets pledged for funds at Lloyd's are not included in this analysis. Details of ABCs are included in note 34(C).

(B) Unlisted equities

The fair value movement in unlisted equities was a gain of \$3 million (2005 \$4.3 million).

(C) Charges over investments and other assets

A controlled entity has given fixed and floating charges over certain of its investments and other assets in order to secure the obligations of the consolidated entity's corporate members at Lloyd's of London as described in note 31. Details of the fixed and floating charges over ABC financial assets pledged for funds at Lloyd's are provided in note 34(C).

## DERIVATIVE FINANCIAL INSTRUMENTS

(A) Derivative financial instruments – fair value

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Assets maturing within 12 months</b>				
Forward foreign exchange contracts	4	11	88	69
<b>Assets maturing in greater than 12 months</b>				
Eurobonds swaps	-	-	14	13
	4	11	102	82
<b>Liabilities maturing within 12 months</b>				
Forward foreign exchange contracts	(10)	(4)	(37)	(35)
	(6)	7	65	47

Swaps relating to ABC securities are included in note 34(C).

## DERIVATIVE FINANCIAL INSTRUMENTS CONTINUED

## (i) Foreign currency risk

Foreign currency risk arises from the translation of net investments in foreign operations to Australian dollars, being both the presentation currency for the consolidated entity and the functional currency of the parent entity. The consolidated entity uses foreign currency interest bearing liabilities and forward foreign exchange contracts to mitigate this risk.

The consolidated entity is also exposed to foreign currency risk on its net position in foreign currencies arising from foreign currency transactions. The consolidated entity uses derivatives to help manage this exposure by entering into forward foreign exchange contracts, some of which involve the exchange of two foreign currencies according to the needs of controlled foreign entities.

Contractual amounts for foreign exchange derivatives outstanding at the balance date include forward foreign exchange contracts to purchase \$10,187 million (2005 \$6,778 million).

The maturity profile of these derivatives is as follows:

	2006 \$M	2005 \$M
Less than one year	10,175	6,766
More than one but less than five years	12	12
	10,187	6,778

## (ii) Market risk

The consolidated entity is exposed to market risk on its investment in equities and fixed interest securities and uses forward contracts and options to help manage this exposure. All derivative positions entered into by the consolidated entity are for economic hedging purposes but do not, in all cases, meet the criteria for hedge accounting. Contractual amounts for forward contracts outstanding at the balance date were \$16 million (2005 \$13 million). There were no amounts outstanding for purchased or written options (2005 \$nil).

The derivative risk management process is subject to regular internal audit and close senior management scrutiny, including regular board and other management reporting. All derivative transactions are subject to authority levels provided to management and the levels of exposure are reviewed on an ongoing basis.

## (B) Hedging arrangements

The consolidated entity has designated the following derivatives as hedges:

TYPE OF HEDGE	DESCRIPTION OF INSTRUMENT	NATURE OF RISKS	FAIR VALUE	
			2006 \$M	2005 \$M
Fair value	Interest rate swaps – ABC securities (due 2008)	Changes in fair value of financial liability due to interest rate risk	(23)	(28)
Cash flow	Cross currency interest rate swaps – Eurobonds	Variability of functional currency cash flows due to interest rate and foreign currency risk	14	13
Cash flow	Cross currency interest rate swaps – ABC securities (due 2009)	Variability of functional currency cash flows due to interest rate and foreign currency risk	(35)	(1)
Net investments in foreign operations	Forward foreign exchange contracts – spot component	Currency risk	31	(21)

At the balance date, \$nil (2005 \$nil) non-derivative interest bearing liabilities were designated as hedges of net investments in foreign operations.

# 13

## RECEIVABLES

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Trade debtors</b>				
Premium receivable <sup>(1)</sup>	-	-	907	917
Reinsurance and other recoveries <sup>(2)</sup>	-	-	771	547
Unclosed premium	-	-	1,417	1,412
			3,095	2,876
<b>Other debtors</b>	-	-	487	505
Treasury receivables	4	27	2	2
Investment receivables	9	10	253	224
Amounts due from controlled entities <sup>(3)</sup>	1,475	1,891	-	-
<b>Receivables – due within 12 months</b>	<b>1,488</b>	<b>1,928</b>	<b>3,837</b>	<b>3,607</b>

(1) Premium receivable is net of an allowance for default of \$53 million (2005 \$52 million).

(2) Reinsurance and other recoveries are net of an allowance for default of \$104 million (2005 \$87 million).

(3) Amounts due from controlled entities are at call.

An allowance for default of reinsurance and other recoveries on outstanding claims of \$139 million (2005 \$152 million) is included in note 22.

# 14

## DEFERRED INSURANCE COSTS (CONSOLIDATED)

	2006 \$M	2005 \$M
Deferred reinsurance premium	498	582
Deferred net commission	688	653
Deferred acquisition costs	223	211
	1,409	1,446

	DEFERRED NET COMMISSION \$M	DEFERRED ACQUISITION COSTS \$M
<b>Deferred costs at 1 January 2005</b>	586	206
Acquisitions	25	-
Costs deferred in financial year	570	182
Amortisation of costs deferred in previous financial years	(528)	(174)
Foreign exchange	-	(3)
<b>Deferred costs at 31 December 2005</b>	653	211
Acquisitions	1	1
Costs deferred in financial year	620	185
Amortisation of costs deferred in previous financial years	(595)	(178)
Foreign exchange	9	4
<b>Deferred costs at 31 December 2006</b>	<b>688</b>	<b>223</b>

## PROPERTY, PLANT AND EQUIPMENT (CONSOLIDATED)

	FREEHOLD BUILDINGS \$M	LEASEHOLD IMPROVEMENTS \$M	OFFICE EQUIPMENT/ FIXTURES & FITTINGS \$M	MOTOR VEHICLES \$M	TOTAL \$M
<b>2006</b>					
<b>Cost or valuation</b>					
At 1 January	91	113	210	14	428
Acquisitions	–	–	1	1	2
Additions	–	18	40	2	60
Revaluations	13	–	–	–	13
Disposals	(2)	(21)	(58)	(3)	(84)
Foreign exchange	–	2	2	–	4
At 31 December	102	112	195	14	423
<b>Accumulated depreciation and impairment losses</b>					
At 1 January	–	39	150	7	196
Disposals	–	(15)	(59)	(2)	(76)
Depreciation charge for the year	–	12	28	2	42
Foreign exchange	–	–	1	–	1
At 31 December	–	36	120	7	163
<b>Carrying amount</b>					
At 31 December 2006	102	76	75	7	260

Principal owner occupied properties are valued annually by the directors effective 31 December based on the independent valuation of various qualified employees of Knight Frank (Australia) Pty Limited. Minor owner occupied properties are included at the independent valuation of other licensed valuers.

All owner occupied properties were valued on the basis of capitalisation of net market rentals allowing for costs of reletting, having regard to comparable on market sales and discounted future cash flows.

In accordance with the consolidated entity's accounting policy, freehold buildings are measured at fair value. The cost of freehold buildings at 31 December 2006 was \$89 million (2005 \$91 million).

	FREEHOLD BUILDINGS \$M	LEASEHOLD IMPROVEMENTS \$M	OFFICE EQUIPMENT/ FIXTURES & FITTINGS \$M	MOTOR VEHICLES \$M	TOTAL \$M
<b>2005</b>					
<b>Cost or valuation</b>					
At 1 January	86	69	235	14	404
Acquisitions	7	1	7	–	15
Additions	–	53	25	3	81
Revaluations	(1)	–	–	–	(1)
Disposals	(1)	(9)	(55)	(3)	(68)
Foreign exchange	–	(1)	(2)	–	(3)
At 31 December	91	113	210	14	428
<b>Accumulated depreciation and impairment losses</b>					
At 1 January	–	40	171	7	218
Disposals	–	(8)	(50)	(2)	(60)
Depreciation charge for the year	–	7	31	2	40
Foreign exchange	–	–	(2)	–	(2)
At 31 December	–	39	150	7	196
<b>Carrying amount</b>					
At 31 December 2005	91	74	60	7	232

## DEFERRED INCOME TAX

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Deferred tax assets	6	-	72	67
Deferred tax liabilities	-	(10)	(359)	(251)
Net	6	(10)	(287)	(184)

(A) Deferred tax assets – maturing in greater than 12 months

(i) The balance comprises temporary differences attributable to:

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Amounts recognised in the income statement</b>				
Impairment provisions	-	-	14	12
Employee benefits	-	-	44	39
Defined benefit superannuation plans	-	-	-	29
Insurance provisions	-	-	69	115
Deferred tax losses recognised	18	11	22	13
Other	3	3	7	15
	21	14	156	223
<b>Amounts recognised directly in equity</b>				
Cash flow hedges	-	-	3	7
Capitalised expenses	2	1	2	1
Defined benefit superannuation plans	-	-	18	19
Employee share options	-	-	25	17
	2	1	48	44
	23	15	204	267
Set-off of deferred tax liabilities	(17)	(15)	(132)	(200)
	6	-	72	67

(ii) Movements:

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Balance at 1 January</b>	15	12	267	201
Credited (charged) to the income statement	7	3	(68)	38
Credited to equity	1	-	4	23
Acquisitions	-	-	1	5
<b>Balance at 31 December</b>	23	15	204	267

(B) Tax losses

The consolidated entity has not brought to account \$1 million (2005 \$1 million) of tax losses, which includes the benefit arising from tax losses in overseas countries. This benefit will only be brought to account when the directors believe it is probable that it will be realised. This benefit of tax losses will only be obtained if:

- the consolidated entity derives future assessable income of a nature and an amount sufficient to enable the benefit from the deductions for the losses to be realised;
- the consolidated entity continues to comply with the conditions for deductibility imposed by tax legislation; and
- no changes in tax legislation adversely affect the consolidated entity in realising the benefit from the deductions for the losses.

Included in deferred tax assets is \$22 million (2005 \$13 million) relating to tax losses which the directors believe will probably be realised.

## DEFERRED INCOME TAX CONTINUED

(C) Deferred tax liabilities – maturing in greater than 12 months

(i) The balance comprises temporary differences attributable to:

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Amounts recognised in the income statement</b>				
Insurance provisions	-	-	(365)	(373)
Foreign currency monetary items	(17)	(24)	(23)	(26)
Financial assets – fair value movements	-	-	(78)	(41)
Other provisions	-	-	(16)	-
Other items	-	(1)	(4)	(10)
	(17)	(25)	(486)	(450)
<b>Amounts recognised directly in equity</b>				
Depreciation	-	-	(5)	(1)
	-	-	(5)	(1)
	(17)	(25)	(491)	(451)
Set-off of deferred tax assets	17	15	132	200
	-	(10)	(359)	(251)

(ii) Movements:

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Balance at 1 January</b>	(25)	(39)	(451)	(250)
Credited (charged) to the income statement	8	-	(36)	(201)
Credited (charged) to equity	-	-	(4)	-
Additions	-	14	-	-
<b>Balance at 31 December</b>	(17)	(25)	(491)	(451)

## INVESTMENT PROPERTIES (CONSOLIDATED)

	2006 \$M	2005 \$M
<b>At 1 January</b>	33	32
Additions	1	4
Disposals	(2)	(2)
Fair value gains (losses)	6	(1)
<b>At 31 December</b>	38	33

The principal investment properties are valued annually by the directors based on the independent valuation of various qualified employees of Knight Frank (Australia) Pty Limited. Minor investment properties are included at the independent valuation of other licensed valuers.

All investment properties were valued on the basis of capitalisation of net market rentals allowing for costs of letting, having regard to comparable on market sales and discounted future cash flows. Investment properties are not expected to be realised within 12 months.

## INVESTMENTS IN CONTROLLED ENTITIES

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING	
		2006 %	2005 %
<b>(A) Parent entity</b>			
QBE Insurance Group Limited	Australia		
<b>(B) Controlled entities</b>			
AIS Green Slip Group Pty Limited	Australia	100.00	100.00
Atlasz Real Estate and Management Company Limited	Hungary	100.00	100.00
Atlasz Utasbiztositasi Egyes Ugynoki Kft	Hungary	100.00	100.00
Austral Mercantile Collections Pty Limited	Australia	100.00	
Australian Aviation Underwriting Pool Pty Limited	Australia	100.00	100.00
BIDV – QBE Insurance Company Limited	Vietnam	–	50.00
British Marine Holdings Limited	Bermuda	100.00	100.00
British Marine Holdings SA	Luxembourg	100.00	100.00
British Marine Holdings II SA	Luxembourg	100.00	100.00
British Marine Luxembourg SA	Luxembourg	100.00	100.00
British Marine Managers Limited	UK	100.00	100.00
CHU Underwriting Agencies Pty Limited	Australia	100.00	100.00
Concord Accident and Health Underwriting Agencies Pty Limited	Australia	100.00	49.90
Concord Accident and Health Underwriting Agencies (SA) Pty Limited	Australia	100.00	49.90
Concord Sports Insurance Agencies Pty Limited	Australia	100.00	49.90
Concord Underwriting Agencies (NSW) Pty Limited	Australia	100.00	49.90
Concord Underwriting Agencies (SA) Pty Limited	Australia	100.00	49.90
Concord Underwriting Agencies Pty Limited	Australia	100.00	49.90
Compania Central de Seguros SA	Colombia	97.48	97.00
Compania Internationale de Asigurari QBE ASITO SA	Moldova	72.60	72.60
Corporate Underwriting Agencies Pty Limited	Australia	100.00	100.00
DA Constable Syndicate (Ireland) Limited	Ireland	100.00	100.00
DA Constable Syndicate Limited	UK	100.00	100.00
DA Constable Syndicate Pty Limited	Australia	100.00	100.00
Energy Insurance Services Limited	UK	100.00	100.00
Ensign Dedicated 1 Limited	UK	100.00	100.00
Ensign Holdings Limited	UK	100.00	100.00
Equator Investments Pty Limited	Australia	100.00	100.00
Equator Reinsurances Limited	Bermuda	100.00	100.00
FAI Insurances (Fiji) Limited	Fiji	100.00	100.00
Greenhill Baia Underwriting GmbH	Germany	100.00	100.00
Greenhill International Insurance Holdings Limited	UK	100.00	100.00
Greenhill Sturge Underwriting Limited	UK	100.00	100.00
Greenhill Underwriting Espana Limited	UK	100.00	100.00
Hyfield Company Limited <sup>(1)</sup>	Thailand	49.00	49.00
Icon Schemes Limited	UK	100.00	100.00
Insurance Consult SRL	Moldova	100.00	100.00
Invivo Medical Pty Limited	Australia	50.00	50.00
Iron Trades Management Services Ltd	UK	100.00	100.00
Limit Corporate Members Limited	UK	100.00	100.00
Limit Holdings Limited	UK	100.00	100.00
Limit No 1 Limited	UK	100.00	100.00
Limit No 2 Limited	UK	100.00	100.00
Limit No 3 Limited	UK	100.00	100.00
Limit No 4 Limited	UK	100.00	100.00
Limit No 5 Limited	UK	100.00	100.00
Limit No 6 Limited	UK	100.00	100.00
Limit No 7 Limited	UK	100.00	100.00

## INVESTMENTS IN CONTROLLED ENTITIES CONTINUED

	COUNTRY OF INCORPORATION/FORMATION	EQUITY HOLDING	
		2006 %	2005 %
Limit No 10 Limited	UK	100.00	100.00
Limit plc	UK	100.00	100.00
Limit Properties Limited	UK	100.00	100.00
Limit Technology and Commercial Underwriting Limited	UK	100.00	100.00
Limit Underwriting Limited	UK	100.00	100.00
Mantis Reef II Limited <sup>(2)</sup>	Cayman Is	-	-
Mantis Reef II Pledge Limited <sup>(2)</sup>	Cayman Is	-	-
Mantis Reef Limited <sup>(2)</sup>	Cayman Is	-	-
Mantis Reef Pledge Limited <sup>(2)</sup>	Cayman Is	-	-
MBP Holdings Limited	UK	100.00	100.00
MiniBus Plus Limited	UK	100.00	100.00
Minster Court Asset Management Limited	UK	100.00	100.00
Minster Court Asset Management Pty Limited	Australia	100.00	100.00
MMIA Pty Limited	Australia	100.00	100.00
MMNSW Pty Limited	Australia	100.00	100.00
MMWC Pty Limited	Australia	100.00	100.00
National Credit Insurance (Brokers) NZ Limited	NZ	100.00	100.00
National Credit Insurance (Brokers) Pty Ltd	Australia	100.00	100.00
National Farmers Union Property and Casualty Company	US	100.00	100.00
Pitt Nominees Pty Limited	Australia	100.00	100.00
PT Asuransi QBE Pool Indonesia	Indonesia	60.00	60.00
QBE (PNG) Limited	PNG	100.00	100.00
QBE (Singapore) Pte Ltd	Singapore	100.00	100.00
QBE Aseguradora de Riesgos del Trabajo SA	Argentina	83.00	83.00
QBE Atlasz Biztosito zrt	Hungary	100.00	100.00
QBE Australia Pty Limited	Australia	100.00	100.00
QBE Brasil Seguros SA	Brazil	100.00	100.00
QBE Capital Funding LP <sup>(2)</sup>	Jersey	-	-
QBE Corporate Capital Holdings plc	UK	100.00	100.00
QBE Corporate Holdings Ltd	UK	100.00	100.00
QBE Corporate Limited	UK	100.00	100.00
QBE Employee Share Trust <sup>(2)</sup>	Australia	-	-
QBE Equities Pty Limited	Australia	100.00	100.00
QBE Funding Limited	Jersey	100.00	100.00
QBE Funding II Limited	Jersey	100.00	100.00
QBE Funding III Limited	Jersey	100.00	100.00
QBE Funding Trust <sup>(2)</sup>	US	-	-
QBE Funding Trust II <sup>(2)</sup>	US	-	-
QBE Funding Trust III <sup>(2)</sup>	US	-	-
QBE Holdings (UK) Limited	UK	100.00	100.00
QBE Holdings Inc	US	100.00	100.00
QBE Hongkong & Shanghai Insurance Limited	Hong Kong	74.47	74.47
QBE Insurance (Australia) Limited	Australia	100.00	100.00
QBE Insurance (Europe) Limited	UK	100.00	100.00
QBE Insurance (Fiji) Limited	Fiji	100.00	100.00
QBE Insurance (Hong Kong) Limited (in liquidation)	Hong Kong	100.00	100.00
QBE Insurance (International) Limited	Australia	100.00	100.00
QBE Insurance (Malaysia) Berhad	Malaysia	51.00	51.00
QBE Insurance (Philippines) Inc	Philippines	59.00	59.00
QBE Insurance (PNG) Limited	PNG	100.00	100.00



## INVESTMENTS IN CONTROLLED ENTITIES CONTINUED

	COUNTRY OF INCORPORATION/FORMATION	EQUITY HOLDING	
		2006 %	2005 %
QBE Insurance (Thailand) Co Limited <sup>(1)</sup>	Thailand		
Thai resident entities		23.67	23.67
Non-Thai resident entities		24.87	24.87
QBE Insurance (Vanuatu) Limited	Vanuatu	100.00	100.00
QBE Insurance (Vietnam) Company Limited	Vietnam	100.00	—
QBE Insurance Company (UK) Limited	UK	100.00	100.00
QBE Insurance Corporation	US	100.00	100.00
QBE International (Investments) Pty Limited	Australia	100.00	100.00
QBE International Holdings (UK) plc	UK	100.00	100.00
QBE International Holdings Limited	Hong Kong	100.00	100.00
QBE Investments (Australia) Pty Limited	Australia	100.00	100.00
QBE Investments (North America) Inc	US	100.00	100.00
QBE Investments (UK) Limited	NZ	100.00	100.00
QBE Investments Pty Limited	Australia	100.00	100.00
QBE Irish Share Incentive Plan <sup>(2)</sup>	Ireland	—	—
QBE IT Services Pty Limited	Australia	100.00	100.00
QBE Jersey (GP) Limited	Jersey	100.00	—
QBE Kindlustuse Eesti AS	Estonia	100.00	100.00
QBE Makedonija <sup>(3)</sup>	Macedonia	65.25	65.25
QBE Management Company (Bermuda) Limited	Bermuda	100.00	100.00
QBE Management (Ireland) Limited	Ireland	100.00	100.00
QBE Management (UK) Limited	UK	100.00	100.00
QBE Management Inc	US	100.00	100.00
QBE Management Services Pty Limited	Australia	100.00	100.00
QBE Management Services (Philippines) Pty Limited	Philippines	100.00	—
QBE Marine Underwriting Agency Pte Limited	Singapore	70.00	70.00
QBE Nominees (PNG) Limited	PNG	100.00	100.00
QBE Nominees Pty Limited	Australia	100.00	100.00
QBE Nordic Aviation Insurance A/S	Denmark	100.00	—
QBE Pacific Insurance Limited	PNG	100.00	100.00
QBE Poistovna AS	Slovakia	100.00	100.00
QBE Re Services Pty Limited	Australia	100.00	100.00
QBE Reinsurance (Bermuda) Limited	Bermuda	100.00	100.00
QBE Reinsurance (Europe) Limited	Ireland	100.00	100.00
QBE Reinsurance (UK) Limited	UK	100.00	100.00
QBE Reinsurance Administration Pty Ltd	Australia	100.00	100.00
QBE Reinsurance Corporation	US	100.00	100.00
QBE Specialty Insurance Company	US	100.00	100.00
QBE UK Finance I Limited	UK	100.00	100.00
QBE UK Finance II Limited	UK	100.00	100.00
QBE UK Share Incentive Plan <sup>(2)</sup>	UK	—	—
QBE Workers Compensation (NSW) Limited	Australia	100.00	100.00
QBE Workers Compensation (SA) Limited	Australia	100.00	100.00
QBE Workers Compensation (VIC) Limited	Australia	100.00	100.00
QBEMM Pty Limited	Australia	100.00	100.00
QBE-UGPB Insurance <sup>(1)</sup>	Ukraine	50.00	50.00
Queensland Insurance (Investments) Limited	Fiji	100.00	100.00
Ridgwell Fox & Partners (Underwriting Management) Limited	UK	100.00	100.00
Sinkaonamahasarn Company Limited <sup>(1)</sup>	Thailand	49.00	49.00
SRL Underwriting Limited	UK	100.00	100.00

## INVESTMENTS IN CONTROLLED ENTITIES CONTINUED

	COUNTRY OF INCORPORATION/FORMATION	EQUITY HOLDING	
		2006 %	2005 %
Star Trust <sup>(2)</sup>	Cayman Is	—	—
Strakh-Consult	Ukraine	100.00	100.00
Sukhothai Re Consultants Limited	Thailand	100.00	100.00
The MiniBus & Coach Club Limited	UK	100.00	100.00
Torch Dedicated Corporate Member Limited	UK	100.00	100.00
Travelon Pty Limited	Australia	100.00	100.00
United Security Insurance Company	US	100.00	100.00
Visionex 2000 Limited	UK	100.00	100.00

(1) The following special conditions exist with respect to the consolidated entity's equity holdings.

- For accounting purposes, the consolidated entity has management control of QBE Insurance (Thailand) Co Ltd and QBE-UGPB Insurance.
- The issued share capital of Hyfield Company Limited and Sinkaonamahasarn Company Limited owned by the consolidated entity is held by various controlled entities. Other controlled entities have the right to acquire the remaining share capital.

(2) Mantis Reef Limited, Mantis Reef II Limited, Mantis Reef Pledge Limited, Mantis Reef II Pledge Limited, QBE Employee Share Trust, QBE Irish Share Incentive Plan, QBE UK Share Incentive Plan, Star Trust, the QBE Funding Trusts and QBE Capital Funding LP have been included in the consolidated financial statements as these entities are special purpose entities that exist for the benefit of the QBE Group.

(3) The shareholding in QBE Makedonija equates to 73.50% (2005 73.50%) of the voting rights.

## (C) Change of name

CONTROLLED ENTITY	FORMER NAME
QBE Management (Ireland) Limited	Universal Management Limited
QBE Investments (Australia) Pty Limited	Queensland Insurance (Australia) Pty Limited
QBE Investments (UK) Limited	QBE WorkAble Limited
Minster Court Asset Management Pty Limited	QBE Finance Pty Limited

## (D) Minority interest in controlled entities (consolidated)

	2006 \$M	2005 \$M
Ordinary share capital	54	57
Reserves	(7)	(6)
Retained profits	19	15
	66	66

## (E) Equity

All equity in controlled entities is held in the form of shares or through contractual arrangements.

## (F) Acquisitions

The following entities were acquired during the financial year:

- On 1 January 2006, a wholly owned entity acquired QBE Insurance (Vietnam) Company Limited (formerly Allianz General Insurance (Vietnam) Co Ltd), a general insurance company in Vietnam.
- On 3 January 2006, a wholly owned entity acquired Austral Mercantile Collections Pty Limited, a debt collection agency.
- On 8 April 2006, a wholly owned entity acquired QBE Nordic Aviation Insurance A/S (formerly Nordic Aviation Insurance A/S), an aviation insurance company in Denmark.
- On 1 July 2006, a wholly owned entity acquired the remaining equity of the Concord Group of companies.
- On 29 September 2006, a wholly owned entity acquired the agricultural business division of OneBeacon Insurance Company, an insurance operation in America.

## INVESTMENTS IN CONTROLLED ENTITIES CONTINUED

## (G) Disposals

On 1 January 2006, a wholly owned entity sold its 50% shareholding in BIDV – QBE Insurance Company Limited in Vietnam to the consolidated entity's joint venture partner in Vietnam.

## (H) Fair value of net assets of controlled entities acquired in the current financial year

	2006 \$M	2005 \$M
Cash and financial assets	21	710
Receivables	3	113
Deferred insurance costs	2	36
Property, plant and equipment	2	15
Trade and other payables	(3)	(181)
Net outstanding claims	(4)	(255)
Unearned premium	(4)	(166)
Provision for income tax	–	(3)
Net deferred income tax	1	5
Other provisions	–	(15)
	18	259
Intangible assets	53	307
Cost of acquisitions	71	566
The net cash flow relating to acquisitions was as follows:		
Cash consideration	71	536
Cash and current financial assets acquired	(7)	(136)
Net cash paid	64	400

The net contribution to the consolidated net profit after income tax for current year acquisitions is \$1 million (2005 \$11 million).

## INTANGIBLE ASSETS (CONSOLIDATED)

	GOODWILL	IDENTIFIABLE INTANGIBLES		TOTAL
		PURCHASED CAPACITY COSTS	OTHER	
2006	\$M	\$M	\$M	\$M
<b>Cost</b>				
At 1 January	1,201	132	52	1,385
Acquisitions	78	–	23	101
Additions	–	1	–	1
Impairment of goodwill	(1)	–	–	(1)
Foreign exchange	(5)	8	(2)	1
At 31 December	1,273	141	73	1,487
<b>Amortisation</b>				
At 1 January	–	–	(3)	(3)
Amortisation for the year	–	–	(9)	(9)
At 31 December	–	–	(12)	(12)
<b>Carrying amount</b>				
At 31 December 2006	1,273	141	61	1,475

## INTANGIBLE ASSETS (CONSOLIDATED) CONTINUED

	GOODWILL	IDENTIFIABLE INTANGIBLES		TOTAL
		PURCHASED CAPACITY COSTS	OTHER	
	\$M	\$M	\$M	\$M
<b>2005</b>				
<b>Cost</b>				
At 1 January	894	135	11	1,040
Acquisitions	265	—	42	307
Additions	43	3	—	46
Foreign exchange	(1)	(6)	(1)	(8)
At 31 December	1,201	132	52	1,385
<b>Amortisation</b>				
At 1 January	—	—	(1)	(1)
Amortisation for the year	—	—	(2)	(2)
At 31 December	—	—	(3)	(3)
<b>Carrying amount</b>				
At 31 December 2005	1,201	132	49	1,382

## (A) Identifiable intangibles

Purchased capacity costs, the most significant component of identifiable intangibles, relate to the acquisition of syndicate capacity at Lloyd's of London. Syndicate capacity is considered to have an indefinite useful life due to the planned long term commitment to, and increasing size of, the consolidated entity's operations in the Lloyd's market. The relevant cash generating unit ("CGU") is Lloyd's operating division. Purchased capacity costs have an indefinite useful life and therefore no amortisation is charged. The value in use over such a period is sufficient to validate the carrying value of the purchased capacity costs.

Other identifiable intangible assets include:

- rights to manage the Ensign business in the UK, which are being amortised over 11 years from the date of acquisition in 2004;
- renewal rights in respect of the acquisition of Icon Schemes Limited in 2004, which are being amortised over three years;
- insurance licenses on the acquisition of National Farmers Union Property and Casualty Company in 2005, which are deemed to have an indefinite useful life and are therefore not amortised;
- renewal rights on the acquisition of the National Farmers Union Property and Casualty Company in 2005, which are being amortised over 20 years; and
- renewal rights on the acquisition of a portfolio of US agricultural business in September 2006, which are being amortised over 15 years.

None of these is individually significant.

## (B) Goodwill

The most significant CGUs are:

- Australian operations, which includes the acquisition of the remaining 50% of the QBE Mercantile Mutual joint venture in 2004;
- QBE Insurance (Europe), which includes the acquisitions of QBE Insurance Company (UK) Limited (formerly Iron Trades) in 1999 and MiniBus Plus in 2005; and
- Limit, which comprises mainly the acquisition of the consolidated entity's operations at Lloyd's of London in 2000.

## (C) Allocation of CGUs

	2006 \$M	2005 \$M
Australian operations	686	626
QBE Insurance (Europe)	182	179
Limit	374	366
Other CGUs	233	211
	<b>1,475</b>	<b>1,382</b>

## (D) Key assumptions

The consolidated entity's accounting policy in respect of impairment testing of goodwill and intangibles is included in note 1(S). The recoverable amount of goodwill and intangibles is determined by reference to a value in use calculation using cash flow projections for the next five years based on information extracted from the latest three year business plan, presented to and approved by the board. No growth is assumed in years four and five.

Discount rates are pre-tax and reflect a beta and equity risk premium appropriate to the consolidated entity.

The terminal value is calculated using a perpetuity growth formula based on the cash flow forecast for year five, and an appropriate discount rate and terminal growth rate.

## TRADE AND OTHER PAYABLES

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Trade payables	—	—	881	838
Amounts due to controlled entities	2,747	1,431	—	—
Other payables and accrued expenses	14	12	515	413
Treasury payables	15	8	44	13
Investment payables	7	6	26	18
<b>Trade and other payables – payable within 12 months</b>	<b>2,783</b>	<b>1,457</b>	<b>1,466</b>	<b>1,282</b>

## 21

## UNEARNED PREMIUM (CONSOLIDATED)

## (A) Unearned premium

	2006 \$M	2005 \$M
<b>At 1 January</b>	<b>4,287</b>	<b>3,948</b>
Acquisitions/disposals	1	166
Deferral of premium on contracts written in the period	4,601	3,849
Earning of premium written in previous periods	(4,305)	(3,667)
Foreign exchange	58	(9)
<b>At 31 December</b>	<b>4,642</b>	<b>4,287</b>

## (B) Net premium liabilities

	NOTE	2006 \$M	2005 \$M
Unearned premium		4,642	4,287
Deferred insurance costs	14	(1,409)	(1,446)
<b>Net premium liabilities</b>		<b>3,233</b>	<b>2,841</b>

## (C) Expected present value of future cash flows for future claims including risk margin

	2006 \$M	2005 \$M
Undiscounted central estimate	2,759	2,348
Risk margin	138	113
	2,897	2,461
Discount to present value	(395)	(280)
<b>Expected present value of future cash flows for future claims including risk margin</b>	<b>2,502</b>	<b>2,181</b>

## (D) Liability adequacy test

The probability of adequacy applied in the liability adequacy test differs from the probability of adequacy adopted in determining the outstanding claims provision. The reason for the difference is that the former is a benchmark used only to test the sufficiency of net premium liabilities whereas the latter is a measure of the adequacy of the outstanding claims provision actually carried by the consolidated entity.

AASB 1023 requires the inclusion of a risk margin in insurance liabilities, but does not prescribe a minimum level of margin. Whilst there is established practice in the calculation of the probability of adequacy of the claims provision, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities. The consolidated entity has adopted a risk margin for the purposes of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA.

## UNEARNED PREMIUM (CONSOLIDATED) CONTINUED

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at 31 December 2006 and 2005.

## (E) Risk margin

The process used to determine the risk margin is explained in note 3(A)(iii).

The risk margin in expected future cash flows for future claims as a percentage of the central estimate is 5.8% (2005 5.5%).

This is the risk margin required to give a probability of adequacy of 75% for total insurance liabilities.

## OUTSTANDING CLAIMS (CONSOLIDATED)

## (A) Net outstanding claims

	2006 \$M	2005 \$M
Gross outstanding claims	17,140	16,694
Claims settlement costs	395	365
	17,535	17,059
Discount to present value	(2,266)	(1,976)
Gross outstanding claims provision	15,269	15,083
Less than 12 months	5,098	4,904
Greater than 12 months	10,171	10,179
Gross outstanding claims provision	15,269	15,083
Reinsurance and other recoveries on outstanding claims <sup>(1)</sup>	4,207	4,769
Discount to present value	(583)	(556)
Reinsurance and other recoveries on outstanding claims	3,624	4,213
Less than 12 months	1,238	1,357
Greater than 12 months	2,386	2,856
Reinsurance and other recoveries on outstanding claims	3,624	4,213
Net outstanding claims	11,645	10,870
Central estimate	10,256	9,627
Risk margin	1,389	1,243
Net outstanding claims	11,645	10,870

(1) Reinsurance and other recoveries on outstanding claims are shown net of an allowance for default of \$139 million (2005 \$152 million).

## (B) Risk margin

The process used to determine the risk margin is explained in note 3(A)(iii). The probability of adequacy at 31 December 2006 is 94.6% (2005 94.1%) which is slightly in excess of the high end of our internal target range of 85% to 94%.

The risk margin included in net outstanding claims is 13.5% of the central estimate (2005 12.9%).

## (C) Reconciliation of movement in discounted outstanding claims provision

	2006			2005		
	GROSS \$M	REINSURANCE \$M	NET \$M	GROSS \$M	REINSURANCE \$M	NET \$M
At 1 January	15,083	(4,213)	10,870	12,605	(3,143)	9,462
Increase in net claims incurred in current accident year	5,559	(702)	4,857	6,874	(2,225)	4,649
Movement in prior year claims provision	(31)	(275)	(306)	(130)	(102)	(232)
Incurred claims recognised in the income statement	5,528	(977)	4,551	6,744	(2,327)	4,417
Acquisitions/disposals	685	(202)	483	387	(76)	311
Net claim payments	(6,025)	1,805	(4,220)	(4,620)	1,309	(3,311)
Foreign exchange	(2)	(37)	(39)	(33)	24	(9)
At 31 December	15,269	(3,624)	11,645	15,083	(4,213)	10,870

## OUTSTANDING CLAIMS (CONSOLIDATED) CONTINUED

## (D) Claims development

## (i) Net undiscounted outstanding claims for the six most recent accident years

	2001 \$M	2002 \$M	2003 \$M	2004 \$M	2005 \$M	2006 \$M	TOTAL \$M
Estimate of net ultimate claims cost:							
At end of accident year	3,693	3,337	3,546	4,815	5,401	5,032	
One year later	3,673	3,217	3,279	4,344	5,211	–	
Two years later	3,786	3,141	3,029	4,081	–	–	
Three years later	3,935	3,104	2,901	–	–	–	
Four years later	3,965	3,051	–	–	–	–	
Five years later	3,896	–	–	–	–	–	
<b>Current estimate of net cumulative claims cost</b>	<b>3,896</b>	<b>3,051</b>	<b>2,901</b>	<b>4,081</b>	<b>5,211</b>	<b>5,032</b>	
Cumulative net payments	(3,180)	(2,118)	(1,825)	(2,135)	(2,149)	(1,131)	
<b>Net undiscounted outstanding claims for the six most recent accident years</b>	<b>716</b>	<b>933</b>	<b>1,076</b>	<b>1,946</b>	<b>3,062</b>	<b>3,901</b>	<b>11,634</b>

The estimates of net ultimate claims cost and cumulative claims payments for the six most recent accident years have been translated to Australian dollars using the closing rate of exchange at 31 December 2006.

## (ii) Reconciliation of net undiscounted outstanding claims for the six most recent accident years to net outstanding claims

	TOTAL \$M
Net undiscounted outstanding claims for the six most recent accident years	11,634
Outstanding claims – accident years 2000 and prior	1,429
Foreign exchange	(289)
Discount on outstanding claims	(1,683)
Claims settlements costs	395
Other	159
<b>Net outstanding claims</b>	<b>11,645</b>

## (iii) Commentary

The claims development table is presented net of reinsurance. With operations in 44 countries, hundreds of products, various reinsurance arrangements and with the consolidated entity's risk tolerance managed on a consolidated net basis, it is not considered meaningful or practicable to provide this information other than on a consolidated net accident year basis.

Outstanding claims in respect of acquisitions are included in the estimate of net ultimate claims cost in the accident year in which the acquisition was made. The exception is increased participation in Lloyd's syndicates, where the increased share of the outstanding claims provision is allocated to the original accident year.

## PROVISIONS

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Long service leave	-	-	20	18
Amounts payable under acquisition agreements	22	13	35	31
Other provisions	-	-	11	15
	22	13	66	64
Payable within 12 months	-	-	1	2
Payable in 12 months or more	22	13	65	62
	22	13	66	64

## INTEREST BEARING LIABILITIES

(A) Analysis of interest bearing liabilities

		THE COMPANY		CONSOLIDATED	
		2006 \$M	2005 \$M	2006 \$M	2005 \$M
Repayable as follows:					
<b>Bank loans</b>					
27 February 2006	AS400 million	-	400	-	400
<b>Senior debt</b>					
28 September 2009	£175 million	433	409	433	409
<b>Eurobonds</b>					
2 August 2020	AS150 million/£58 million	-	-	149	149
2 August 2020	AS20 million/£8 million	-	-	20	20
2 August 2020	€115 million/£70 million	-	-	190	185
		-	-	359	354
<b>Hybrid securities<sup>(1)</sup></b>					
15 April 2022	US\$101 million (2005 US\$201 million)	-	-	77	165
21 September 2024	US\$558 million (2005 US\$558 million)	-	-	447	466
		-	-	524	631
<b>Subordinated debt</b>					
1 July 2023	US\$250 million	312	336	312	336
<b>Capital securities</b>					
No fixed date	£300 million	-	-	736	-
<b>Total interest bearing liabilities<sup>(2)</sup></b>		<b>745</b>	<b>1,145</b>	<b>2,364</b>	<b>2,130</b>
Payable within 12 months		-	400	77	400
Payable in 12 months or more		745	745	2,287	1,730
<b>Total interest bearing liabilities<sup>(2)</sup></b>		<b>745</b>	<b>1,145</b>	<b>2,364</b>	<b>2,130</b>

(1) Hybrid securities are shown net of the equity conversion option. The US dollar principal amounts shown are the outstanding amounts payable at the end of the 20 year term.

(2) ABC securities for funds at Lloyd's are not included in this analysis. Details of ABCs are included in note 34(C).



## INTEREST BEARING LIABILITIES CONTINUED

### (B) Finance costs

\$8 million of finance costs have been capitalised in the year (2005 \$nil).

### (C) Security and facility arrangements

In the normal course of business, bank loans are made to controlled entities and secured by guarantees or letters of comfort given by the company.

The Eurobonds were issued by a controlled entity and secured by guarantees given by the company and another controlled entity. The US\$250 million subordinated debt was issued by the company. The claims of bondholders pursuant to both of these interest bearing liabilities will be subordinated in right of payment to the claims of all senior creditors, including policyholders, of the relevant controlled entity.

The hybrid securities are guaranteed by the company and a controlled entity. The claims of investors under these guarantees in general will rank equally with all existing and future unsecured and unsubordinated indebtedness of the company and the controlled entity.

The performance of the obligations of the controlled entity under the capital securities is guaranteed by the company. The guarantee is an unsecured and subordinated obligation of the company. The guarantee ranks senior to the claims of the holders of ordinary shares of the company, equally with equally ranked securities and instruments of the company and junior to the claims of creditors of the company.

### (D) Eurobonds

A controlled entity is exposed to interest rate and currency risk in respect of its three Eurobond financing arrangements. Accordingly, the consolidated entity has entered into swap agreements which result in the consolidated entity's financial liabilities being fixed at sterling amounts until 2010, at which point the consolidated entity will be liable for the original Australian dollar and Euro amounts in the underlying financing arrangements. The facility can be extended for a further 10 years to 2020. Under the swap agreements, the variable interest rates of between 1.8% and 2.0% above the wholesale interbank rate are swapped to fixed rates of between 8.4% and 8.6% payable quarterly until 2010. The timing of the payments under the swap agreements matches the dates on which interest is payable on the underlying debt. The contracts are settled on a net basis.

The underlying financial liabilities are measured at amortised cost in original currency and translated to Australian dollars at the closing rate of exchange. The swaps are measured at fair value. The swaps are designated as cash flow hedges and have satisfied the relevant hedge effectiveness tests throughout the year and at the balance date. The gain or loss on the cash flow hedges is recognised directly in equity. Any ineffectiveness in the cash flow hedges is recognised directly in the income statement. Each financial year end, until the close out of the swap agreements in 2010, an amount is transferred from equity to the income statement to offset:

- the differential between the fixed and variable interest payments; and
- the movement in the spot rate on the financial liabilities.

During the year, a gain of \$nil (2005 gain before tax of \$2 million) was recognised in equity relating to the movements in the fair value of the swaps. During the year, a loss before tax of \$14 million (2005 gain before tax of \$2 million) was transferred from equity and included in the income statement.

### (E) Hybrid securities

#### (i) Hybrid securities due 2024

In 2004, a controlled entity issued US\$375 million of 20 year hybrid securities. Investors have the option to convert the security if:

- the company calls for their redemption;
- the market value of the security is less than the market value of the underlying shares in the company for five consecutive trading days; or
- certain corporate transactions occur (e.g. change in control).

In the event of conversion, approximately 29 million shares will be issued.

#### (ii) Hybrid securities due 2022

In 2002, two controlled entities issued US\$471 million of 20 year hybrid securities. Investors have the option to convert the security if:

- the company calls for their redemption;
- the market value of the security is less than the market value of the underlying shares in the company for two consecutive trading days; or
- certain corporate transactions occur (e.g. change in control).

In 2006, 14 million shares (2005 28 million) were issued as a result of the conversion of 12% (2005 24%) of the hybrid securities due 2022. In the event of conversion of the remaining securities, approximately 13 million shares will be issued.

## INTEREST BEARING LIABILITIES CONTINUED

## (F) Capital securities

In 2006, a controlled entity issued £300 million of capital securities. The securities have no fixed redemption date and may not be called for redemption or conversion by the investors.

The securities are subordinated. Distributions are deferrable and not cumulative. However, if a distribution or principal amount is not paid by the controlled entity, and the company does not pay the amount under the guarantee, then the capital securities are to be redeemed for OBE preference shares. For so long as the distributions or principal amounts are outstanding, no payments (including distributions or principal amounts) are to be made on the company's shares or other instruments ranking junior to the securities. However, payment of distributions or principal amounts on equal ranking securities may be paid proportionally.

## (G) Fair value of interest bearing liabilities

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Bank loans	-	400	-	400
Senior debt	433	423	433	423
Eurobonds	-	-	363	358
Hybrid securities	-	-	1,212	1,105
Subordinated debt	291	350	291	350
Capital securities	-	-	755	-
	<b>724</b>	<b>1,173</b>	<b>3,054</b>	<b>2,636</b>

There has been no active trading of interest bearing liabilities during 2006. The fair value has been estimated using valuation techniques based on market available data for similar debt instruments.

Hybrid securities have been valued with reference to the underlying market value of shares in the consolidated entity. The ability to convert the hybrid securities is restricted by the terms and conditions included in note 24(E).

## CONTRIBUTED EQUITY

## (A) Share capital (company and consolidated)

	2006 \$M	2005 \$M
Issued ordinary shares, fully paid	3,461	3,195
	<b>NUMBER OF SHARES 000</b>	<b>\$M</b>
<b>Issued and fully paid at 1 January 2005</b>	734,609	2,780
Shares issued under the Employee Share and Option Plan	3,701	30
Employee options exercised	319	4
Vendor options exercised	1,591	28
Shares issued under Dividend Reinvestment Plan	13,051	203
Shares issued under Dividend Election Plan	3,437	—
Shares issued to holders of hybrid securities	28,113	153
Shares issued under the Deferred Compensation Plan on vesting of conditional rights	472	—
Share issue expenses	—	(3)
Bonus shares	1	—
<b>Issued and fully paid at 31 December 2005</b>	785,294	3,195
Shares issued under the Employee Share and Option Plan	1,996	15
Employee options exercised	3,860	36
Vendor options exercised	944	22
Shares issued under Dividend Reinvestment Plan	5,740	117
Shares issued under Dividend Election Plan	473	—
Shares issued to holders of hybrid securities	13,865	81
Shares issued under the Deferred Compensation Plan on vesting of conditional rights	283	—
Share issue expenses	—	(5)
Bonus shares	3	—
<b>Issued and fully paid at 31 December 2006</b>	812,458	3,461
<b>Shares notified to the Australian Stock Exchange</b>	818,679	3,514
Less: Plan shares subject to non-recourse loans, derecognised under Australian GAAP	(6,221)	(53)
<b>Issued and fully paid at 31 December 2006</b>	812,458	3,461

Ordinary shares in the company have no par value and entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of shares held. Ordinary shareholders rank after all creditors and are entitled to any residual proceeds.

## (B) Treasury shares held in trust

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>At 1 January</b>	—	—	—	—
Acquisition of shares	—	—	38	—
Shares vested and/or released to participants	—	—	(22)	—
<b>At 31 December</b>	—	—	16	—

Shares in the company may be bought on market to satisfy future obligations of the company under the various employee share based remuneration plans. Any such shares are held in trust. On consolidation, these shares are recognised as treasury shares held in trust. The balance of the treasury shares held in trust at the balance date represents the cumulative cost of acquiring shares in the company that have not yet been distributed to employees as share based remuneration.

## (C) Equity component of hybrid securities

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>At 1 January</b>	108	108	108	108
Movement during the period	—	—	—	—
<b>At 31 December</b>	108	108	108	108

## CONTRIBUTED EQUITY CONTINUED

## (D) Dividend Reinvestment and Dividend Election Plans

The company operates a Dividend Reinvestment Plan ("DRP") and a Dividend Election Plan ("DEP"). The DRP and DEP have been reinstated for the final dividend having been suspended for the interim dividend in September 2006.

The last date of receipt of election notices applicable to the final dividend was 22 February 2007.

## (E) Dividends (company and consolidated)

	2006 \$M	2005 \$M
Previous year final dividend paid on ordinary shares		
Franked at 50% - 19.0 cents (2005 15.0 cents, franked at 50%)	151	114
Unfranked - 19.0 cents (2005 15.0 cents)	151	114
	302	228
Interim dividend paid on ordinary shares		
Franked at 60% - 24.0 cents (2005 16.5 cents, franked at 50%)	193	127
Unfranked - 16.0 cents (2005 16.5 cents)	129	127
	322	254
Dividend reinvested under the Dividend Election Plan	(10)	(55)
<b>Total dividend paid</b>	<b>614</b>	<b>427</b>

The interim dividend of \$322 million was paid on 14 September 2006. On 23 February 2007, the directors declared a 60% franked final dividend of 55.0 cents per share (2005 38.0 cents per share, 50% franked). The final dividend payout is \$452 million (2005 \$302 million).

The franking account balance on a tax paid basis as at the balance date was a surplus of \$206 million (2005 \$213 million). After taking into account the final dividend, the franking account balance will be a surplus of \$90 million.

Following the introduction of the conduct foreign income ("CFI") rules effective for the consolidated entity from 1 January 2006, shareholders not resident in Australia will receive CFI unfranked dividends for the unfranked portion of the final 2006 dividend exempt from Australian tax and not subject to Australian withholding tax.

## (F) Options issued to third parties

The consolidated entity has issued options to third parties in respect of acquisitions. These options are subject to performance hurdles. Details of the movements in respect of such options during the year are as follows:

2006 GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2006	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2006	EXPIRY DATE
1 December 2004	\$0.00	3,000,000	1,500,000	-	1,500,000	30 November 2007
22 December 2004	\$0.00	2,750,000	-	2,750,000	-	31 July 2006
		5,750,000	1,500,000	2,750,000	1,500,000	

Details of the movements in respect of such options during the prior year were as follows:

2005 GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2005	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2005	EXPIRY DATE
1 December 2004	\$0.00	5,000,000	2,000,000	-	3,000,000	30 November 2007
22 December 2004	\$0.00	2,750,000	-	-	2,750,000	31 July 2006
		7,750,000	2,000,000	-	5,750,000	

The market value of the options issued to third parties outstanding at the balance date is \$22 million (2005 \$68 million), calculated by reference to the quoted market value of the underlying shares at that date. During the financial year, 1,500,000 (2005 2,000,000) options were exercised, resulting in the issue of 943,500 (2005 1,591,000) shares.

## OTHER RESERVES

## (A) Reserves

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Owner occupied property revaluation reserve<sup>(1)</sup></b>				
At 1 January	-	-	8	6
Valuation increase	-	-	13	2
Deferred tax	-	-	(4)	-
At 31 December	-	-	17	8
<b>Cash flow hedges reserve<sup>(2)</sup></b>				
At 1 January	(5)	-	(22)	(17)
Fair value (loss) gain	(34)	(1)	(34)	1
Transfer of loss (gain) to income statement	41	(4)	55	(6)
Deferred tax	-	-	(4)	-
At 31 December	2	(5)	(5)	(22)
<b>Foreign currency translation reserve<sup>(3)</sup></b>				
At 1 January	-	-	(72)	(48)
Gains (losses) on translation	-	-	37	(48)
(Losses) gains on forward foreign exchange contracts	-	-	(22)	26
Other decrease	-	-	(2)	(2)
At 31 December	-	-	(59)	(72)
<b>Options reserve<sup>(4)</sup></b>				
At 1 January	38	15	55	19
Options expense	26	23	26	23
Transfers from reserve on vesting of conditional rights	(22)	-	(22)	-
Deferred tax	-	-	24	13
At 31 December	42	38	83	55
<b>General reserve<sup>(5)</sup></b>				
At 1 January	-	-	5	5
Movement in the year	-	-	-	-
At 31 December	-	-	5	5
<b>Realised capital profits reserve<sup>(6)</sup></b>				
At 1 January	-	-	6	6
Movement in the year	-	-	-	-
At 31 December	-	-	6	6
<b>Total reserves at 31 December</b>	<b>44</b>	<b>33</b>	<b>47</b>	<b>(20)</b>

(1) Used to recognise fair value movements in the carrying value of owner occupied property. Refer note 1(Q).

(2) Used to record gains or losses on a hedging instrument in a cash flow hedge that are recognised directly in equity. Refer note 1(O)(ii).

(3) Exchange gains and losses arising on translation of a foreign controlled entity and related hedging instruments are taken to the foreign currency translation reserve. Refer note 1(U). In the event of the disposal of a relevant net investment, the movement in the reserve is recognised in the income statement.

(4) Used to recognise the fair value of instruments issued as share based payments.

(5) Established prior to 1989 for general purposes.

(6) Realised capital profits arising prior to the introduction of capital gains tax in Australia.

## (B) Retained profits

NOTE	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Retained profits at 1 January</b>	<b>2,362</b>	<b>1,729</b>	<b>1,810</b>	<b>1,173</b>
Net profit after income tax attributable to members of the company	2,279	1,060	1,483	1,091
Actuarial gains (losses) on defined benefit superannuation plans, net of tax	29(C)	-	4	(27)
Total available for appropriation	4,641	2,789	3,297	2,237
Dividends paid	(614)	(427)	(614)	(427)
<b>Retained profits at 31 December</b>	<b>4,027</b>	<b>2,362</b>	<b>2,683</b>	<b>1,810</b>

## SHARE BASED PAYMENTS

### (A) Employee Share and Option Plan

The company, at its 1981 AGM, approved the issue of shares from time to time under an Employee Share and Option Plan ("the Plan"), up to 5% of the issued ordinary shares in the capital of the company. Any full-time or part-time employee of the consolidated entity or equally owned joint ventures who is offered shares or options pursuant to the offer document of the Plan is eligible to participate in the Plan.

Under the Plan, ordinary shares of the company are offered at the weighted average market price during the five trading days up to the date of the offer. Likewise, the exercise price for options offered under the Plan is the weighted average market price during the five trading days up to the date of the offer.

In accordance with the terms of the Plan, interest free loans are granted to employees to subscribe for shares issued under the Plan. Prior to 20 June 2005, the terms of the loans were either personal recourse or non-recourse. With effect from 20 June 2005, only personal recourse loans are granted to employees to subscribe for shares under the Plan. The loans are repayable in certain circumstances as set out in the Plan, such as termination of employment or breach of condition.

Currently there are two schemes operating within the Plan:

#### (i) Deferred Compensation Plan

Senior management are invited to participate in the Deferred Compensation Plan ("DCP"). Under the DCP, the directors can issue conditional rights to shares and grant options to senior management who have already achieved predetermined performance criteria. The terms of the DCP may vary to take into account the requirements and market conditions of the locations of senior management, but the general terms of the DCP conditional rights and options are set out below.

- The conditional rights entitle relevant employees to receive shares on the third anniversary of the grant of the rights. Further shares are issued in relation to the conditional rights to reflect dividends paid on ordinary shares of the company in the period commencing from the date of the grant of the conditional rights. The shares issued pursuant to the conditional rights are issued without payment being made by senior management (i.e. at a nil exercise price).
- The options are subject to the terms and conditions of the Plan. Options issued in 2004 and prior can be exercised after three years, whilst any options issued in 2005 and thereafter will generally be exercisable after five years. They must be exercised within a 12 month period after vesting. Interest free personal recourse loans are granted on the terms permitted by the Plan as described above to persons who hold options to fund the exercise of options.

The shares issued pursuant to the conditional rights and options will only be issued if the individual has remained in the company's service throughout the vesting period (unless they leave due to redundancy, retirement through ill health or age, or death) and is not subject to disciplinary proceedings or notice on that date.

Shareholder approval of the DCP was given at the 2006 AGM for the purpose of ASX Listing Rule 7.2, sections 200B and 200E of the *Corporations Act 2001* and for all other purposes.

#### (ii) Share Incentive Plan

Generally, all full-time or part-time employees of the consolidated entity with a minimum of one year's service are invited to participate in the Share Incentive Plan ("the SIP"). Under the SIP, directors can provide shares up to \$1,000 to employees without payment being made by employees. The allocation of shares is based on the period of service. The shares are purchased on market and held in trust for the employee for a minimum of three years or until cessation of employment, whichever is earlier. Further details are provided in note 27(E).

### (B) Employee options

During the year, the company granted to 308 (2005 340) qualifying employees options over ordinary shares with a total market value of \$54 million (2005 \$55 million), being the quoted market price at the date the options were granted. The weighted average fair value of options granted during the year ended 31 December 2006 was \$4.58 (2005 \$3.80).

The market value of the options outstanding at balance date is \$262 million (2005 \$210 million), calculated by reference to the quoted market value of the underlying shares at that date.

## SHARE BASED PAYMENTS CONTINUED

Details of the number of employee options granted, exercised and forfeited or cancelled during the year, including those issued under the DCP, were as follows:

2006 GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2006	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2006
2 April 2001	\$10.72	28,014	—	(27,014)	(1,000)	—
25 May 2001	\$10.65	317,500	—	(317,500)	—	—
1 June 2001	\$10.69	155,000	—	(155,000)	—	—
10 December 2001	\$7.27	810,000	—	(80,000)	—	730,000
18 March 2002	\$7.49	26,637	—	(26,637)	—	—
14 November 2002	\$7.37	100,000	—	(100,000)	—	—
13 March 2003	\$8.04	2,400,718	—	(2,293,208)	(57,485)	50,025
10 April 2003	\$8.04	110,884	—	(110,884)	—	—
3 November 2003	\$10.14	10,000	—	(10,000)	—	—
3 March 2004	\$8.04	209,637	—	(45,190)	—	164,447
3 March 2004	\$11.08	2,986,335	—	(319,470)	(142,843)	2,524,022
2 April 2004	\$11.08	114,694	—	—	—	114,694
3 March 2005	\$8.04	225,043	—	(51,304)	—	173,739
3 March 2005	\$11.08	207,182	—	(20,682)	—	186,500
3 March 2005	\$14.85	2,818,359	—	(185,201)	(158,004)	2,475,154
8 April 2005	\$14.85	118,587	—	—	—	118,587
12 May 2005	\$14.81	100,000	—	(20,000)	—	80,000
2 March 2006	\$20.44	—	2,555,689	(92,779)	(103,077)	2,359,833
7 April 2006	\$20.44	—	94,771	—	—	94,771
		10,738,590	2,650,460	(3,854,869)	(462,409)	9,071,772
Weighted average exercise price		\$10.96	\$20.44	\$9.28	\$14.08	\$14.29

The weighted average share price at the date of exercise of options during the year was \$21.75 (2005 \$15.67). The weighted average remaining contractual life of total options outstanding at 31 December 2006 was 3.15 years (2005 2.79 years).

Employee options outstanding at 31 December 2006 were as follows:

YEAR OF EXPIRY	FUTURE PERFORMANCE	DCP/STI	OTHER	TOTAL OPTIONS
2007	730,000	145,337	—	875,337
2008	—	2,667,101	—	2,667,101
2009	80,000	115,426	—	195,426
2010	—	192,147	—	192,147
2011	—	2,912,371	—	2,912,371
2012	—	2,188,640	—	2,188,640
2024	—	—	40,750	40,750
	810,000	8,221,022	40,750	9,071,772
Vested and exercisable at 31 December 2006	20,000	13,755	40,750	74,505

The future performance options have been issued subject to the achievement of specific performance criteria. Examples of such criteria are provided in the directors' report.

Other options were issued to US and Irish employees in 2004 in lieu of shares under the Plan. The options vested immediately and are exercisable until March 2024.

Regular options have been phased out and replaced with the incentive arrangement under the DCP.

## SHARE BASED PAYMENTS CONTINUED

Details of the number of options granted, exercised and forfeited or cancelled during the prior year, including those issued under the DCP, were as follows:

2005 GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2005	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2005
1 June 2000	\$6.53	10,000	-	(10,000)	-	-
1 July 2000	\$7.62	10,000	-	(10,000)	-	-
1 October 2000	\$8.63	45,730	-	(44,730)	(1,000)	-
1 November 2000	\$8.90	50,000	-	(50,000)	-	-
1 January 2001	\$9.76	5,000	-	(5,000)	-	-
2 April 2001	\$10.72	67,728	-	(36,814)	(2,900)	28,014
25 May 2001	\$10.65	335,000	-	(17,500)	-	317,500
1 June 2001	\$10.69	155,000	-	-	-	155,000
10 December 2001	\$7.27	965,000	-	(130,000)	(25,000)	810,000
18 March 2002	\$7.49	745,070	-	(707,649)	(10,784)	26,637
14 November 2002	\$7.37	100,000	-	-	-	100,000
13 March 2003	\$8.04	2,755,728	1,094	(280,733)	(75,371)	2,400,718
10 April 2003	\$8.04	110,884	-	-	-	110,884
3 November 2003	\$10.14	10,000	-	-	-	10,000
3 March 2004	\$8.04	209,637	-	-	-	209,637
3 March 2004	\$11.08	3,263,378	-	(149,586)	(127,457)	2,986,335
2 April 2004	\$11.08	114,694	-	-	-	114,694
3 March 2005	\$8.04	-	225,043	-	-	225,043
3 March 2005	\$11.08	-	207,182	-	-	207,182
3 March 2005	\$14.85	-	2,960,740	(75,225)	(67,156)	2,818,359
15 March 2005	\$15.13	-	135,250	-	(135,250)	-
8 April 2005	\$14.85	-	118,587	-	-	118,587
12 May 2005	\$14.81	-	100,000	-	-	100,000
		8,952,849	3,747,896	(1,517,237)	(444,918)	10,738,590
Weighted average exercise price		\$9.22	\$14.24	\$8.49	\$12.06	\$10.96



## SHARE BASED PAYMENTS CONTINUED

Employee options outstanding at 31 December 2005 were as follows:

YEAR OF EXPIRY	FUTURE PERFORMANCE	REGULAR	DCP/STI	OTHER	TOTAL OPTIONS
2006	582,500	28,014	26,637	-	637,151
2007	810,000	-	2,603,262	-	3,413,262
2008	-	-	3,147,756	-	3,147,756
2009	100,000	-	116,992	-	216,992
2010	-	-	126,175	-	126,175
2011	-	-	3,126,004	-	3,126,004
2024	-	-	-	71,250	71,250
	1,492,500	28,014	9,146,826	71,250	10,738,590
Vested and exercisable at					
31 December 2005	20,000	-	-	71,250	91,250

## (C) Conditional rights

Details of the number of employee entitlements to conditional rights to ordinary shares under the DCP granted, vested and transferred to employees during the year were as follows:

2006 GRANT DATE	DATE EXERCISABLE	FAIR VALUE PER RIGHT AT GRANT DATE	BALANCE AT 1 JAN 2006	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED TO EMPLOYEE IN THE YEAR	CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2006
13 March 2003	13 March 2006	\$9.16	241,834	-	4,468	(246,302)	-	-
13 March 2003	13 March 2006	\$9.56	582,437	-	9,145	(577,860)	(13,722)	-
13 March 2003	13 March 2006	\$9.71	146,722	-	2,728	(149,450)	-	-
10 April 2003	10 April 2006	\$9.16	47,026	-	874	(47,900)	-	-
3 March 2004	2 March 2007	\$11.65	85,109	-	2,432	(18,346)	-	69,195
3 March 2004	2 March 2007	\$12.49	314,805	-	10,964	(40,306)	(20,191)	265,272
3 March 2004	2 March 2007	\$12.96	690,331	-	22,815	(79,478)	(21,752)	611,916
3 March 2004	2 March 2007	\$13.24	100,309	-	3,655	-	-	103,964
2 April 2004	1 April 2007	\$12.49	45,651	-	1,663	-	-	47,314
3 March 2005	2 March 2008	\$15.30	87,847	-	2,471	(20,026)	-	70,292
3 March 2005	2 March 2008	\$15.86	80,877	-	2,653	(8,074)	-	75,456
3 March 2005	2 March 2008	\$16.94	307,893	-	10,618	(29,201)	(17,676)	271,634
3 March 2005	2 March 2008	\$17.51	634,462	-	21,657	(51,708)	(29,972)	574,439
3 March 2005	2 March 2008	\$17.81	108,545	-	3,956	-	(3,756)	108,745
8 April 2005	7 April 2008	\$16.94	45,361	-	1,652	-	-	47,013
2 March 2006	1 March 2009	\$23.09	-	884,758	31,758	(39,699)	(32,657)	844,160
7 April 2006	6 April 2009	\$24.23	-	35,539	622	-	-	36,161
			3,519,209	920,297	134,131	(1,308,350)	(139,726)	3,125,561

The weighted average share price at the date of vesting of conditional rights during the year ended 31 December 2006 was \$21.49 (2005 \$15.87). The weighted average fair value of conditional rights granted during the year ended 31 December 2006 was \$23.13 (2005 \$17.15).

## SHARE BASED PAYMENTS CONTINUED

Details of the number of employee entitlements to conditional rights to ordinary shares under the DCP granted, vested and transferred to employees during the prior year were as follows:

2005 GRANT DATE	DATE EXERCISABLE	FAIR VALUE PER RIGHT AT GRANT DATE	BALANCE AT 1 JAN 2005	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED TO EMPLOYEE IN THE YEAR	CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2005
18 March 2002	17 March 2005	\$8.40	193,441	–	3,537	(194,858)	(2,120)	–
13 March 2003	13 March 2006	\$9.16	250,212	445	9,915	(10,774)	(7,964)	241,834
13 March 2003	13 March 2006	\$9.56	664,341	–	24,266	(93,368)	(12,802)	582,437
13 March 2003	13 March 2006	\$9.71	145,229	–	5,901	(2,226)	(2,182)	146,722
10 April 2003	10 April 2006	\$9.16	45,177	–	1,849	–	–	47,026
3 March 2004	2 March 2007	\$11.65	81,763	–	3,346	–	–	85,109
3 March 2004	2 March 2007	\$12.49	325,267	–	12,845	(14,103)	(9,204)	314,805
3 March 2004	2 March 2007	\$12.96	732,536	–	29,021	(53,152)	(18,074)	690,331
3 March 2004	2 March 2007	\$13.24	101,372	–	4,107	(2,927)	(2,243)	100,309
2 April 2004	1 April 2007	\$12.49	43,856	–	1,795	–	–	45,651
3 March 2005	2 March 2008	\$15.30	–	84,393	3,454	–	–	87,847
3 March 2005	2 March 2008	\$15.86	–	77,695	3,182	–	–	80,877
3 March 2005	2 March 2008	\$16.94	–	305,675	12,444	(9,246)	(980)	307,893
3 March 2005	2 March 2008	\$17.51	–	717,906	27,662	(91,304)	(19,802)	634,462
3 March 2005	2 March 2008	\$17.81	–	106,760	4,323	–	(2,538)	108,545
8 April 2005	7 April 2008	\$16.94	–	44,470	891	–	–	45,361
			2,583,194	1,337,344	148,538	(471,958)	(77,909)	3,519,209

## (D) Fair value of options and conditional rights

The fair value of both options and conditional rights is determined using a binomial model. The fair value is earned evenly over the period between grant and vesting. For those options and conditional rights granted during the year to 31 December 2006, the following significant assumptions were used:

		OPTIONS		CONDITIONAL RIGHTS	
		2006	2005	2006	2005
Share price on grant date	\$	20.44 – 22.17	14.85 – 15.17	20.44 – 22.17	14.85 – 15.17
Fair value of instrument at grant date	\$	3.85 – 5.63	3.04 – 6.90	23.09 – 24.23	15.30 – 17.81
Risk free interest rate	%	5.2 – 5.4	5.5 – 5.6	5.2 – 5.4	5.5
Expected share price volatility	%	25.0	25.0	25.0	25.0
Expected dividend yield	%	3.5	3.5	3.5	3.5
Expected life of instrument	years	3.5 – 5.5	3.5 – 5.5	3.0	3.0

Some of the assumptions, including expected share price volatility, are based on historical data which does not necessarily represent future trends. Reasonable changes in these assumptions would not have a material impact on the financial statements.

## (E) Share Incentive Plan

The SIP was introduced during 2005 and is a global reward scheme available to eligible permanent employees who have met minimum service conditions at the annual grant date. Under the SIP, eligible employees may be offered up to \$1,000 of fully paid ordinary shares in the company annually for no cash consideration. The market value of shares issued under the SIP is expensed in the period in which the shares are granted. The total number of shares issued under the SIP to participating employees in the year was 148,035 (2005 235,450). The weighted average market price on the issue date was \$23.42 (2005 \$17.09).

## SHARE BASED PAYMENTS CONTINUED

## (F) Share based payment expenses

Total expenses arising from share based payment transactions during the year included in underwriting expenses were as follows:

	CONSOLIDATED	
	2006 \$M	2005 \$M
Options provided under the DCP	8	6
Conditional rights provided under the DCP	18	16
Shares provided under the SIP	4	4
	<b>30</b>	<b>26</b>

## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED)

Key management personnel are those persons defined as having authority and responsibility for planning, directing and controlling the activities of the consolidated entity, either directly or indirectly, including any director (executive or non-executive).

## (A) Directors

The following directors held office during the financial year:

## Non-executive directors

EJ Cloney (chairman)

LF Bleasel AM

DM Boyle (appointed 28 September 2006)

The Hon NF Greiner AC

IF Hudson

BJ Hutchinson

CLA Irby

IYL Lee

## Executive director

FM O'Halloran

## (B) Other key management personnel

All of the persons in the table below were key management personnel for some period during the year ended 31 December 2006 and were key management personnel in the prior year.

NAME	POSITION	EMPLOYER	EMPLOYMENT DATES
SP Burns	Chief executive officer, European operations	QBE Management (UK) Limited	1 January 1987
NG Drabsch	Chief financial officer, QBE Insurance Group Limited	QBE Management Services Pty Limited	20 September 1991
PE Grove	Chief underwriting officer, European operations	QBE Management (UK) Limited	1 August 1982
MD ten Hove	Group general manager, investments, QBE Insurance Group Limited	QBE Management Services Pty Limited	1 March 1999
RL Jones <sup>(1)</sup>	Group general manager, business development, QBE Insurance Group Limited	QBE Management Services Pty Limited	1 April 1994 to 31 October 2006
TM Kenny	President and chief executive officer, the Americas	QBE Reinsurance Corporation	28 November 1994
V McLenaghan	Chief operating officer, QBE Insurance Group Limited	QBE Management Services Pty Limited	14 August 1995
EG Tollifson <sup>(1)</sup>	Chief risk officer, QBE Insurance Group Limited	QBE Management Services Pty Limited	14 February 1994 to 3 July 2006

(1) These persons ceased being key management personnel from 1 July 2006.

## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED) CONTINUED

## (C) Key management personnel - compensation

	COMPANY		CONSOLIDATED	
	2006 \$'000	2005 \$'000	2006 \$'000	2005 \$'000
Short term employee benefits	-	-	21,927	23,977
Post employment benefits	-	-	1,124	1,194
Other long term employment benefits	-	-	189	142
Share based payments	-	-	5,415	4,980
Termination benefits	-	-	1,236	-
	-	-	29,891	30,293

The company has taken advantage of the relief provided by ASIC class order 06/50 and has transferred the detailed remuneration disclosures to the directors' report. Refer to the remuneration report on pages 57 to 67 of the directors' report.

## (D) Key management personnel - equity instruments

## (i) Options and conditional rights provided as remuneration

For details of equity instruments (conditional rights and options) provided to key management personnel as remuneration and shares issued on the exercise of such instruments, together with the associated terms and conditions, refer to the remuneration report on pages 57 to 67. No equity compensation was provided to the non-executive directors.

## (ii) DCP options holdings

Details of the movements in the number of DCP options over ordinary shares in the company provided as remuneration under the DCP to the key management personnel are provided below:

2006 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2006	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	FORFEITED/ CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2006 <sup>(1)</sup>	EXERCISE COST AT 31 DEC 2006 \$'000
<b>Executive director</b>						
FM O'Halloran	344,165	94,771	(110,884)	-	328,052	4,969
<b>Other key management personnel</b>						
SP Burns	389,766	110,515	(78,206)	-	422,075	5,458
NG Drabsch	198,130	50,460	(62,381)	-	186,209	2,789
TM Kenny	307,715	68,986	(144,747)	-	231,954	3,501
V McLenaghan	120,584	39,141	(22,287)	-	137,438	2,072
PE Grove	349,538	95,853	(113,470)	-	331,921	4,718
MD ten Hove	66,707	46,799	-	-	113,506	1,947
<b>Former key management personnel<sup>(2)</sup></b>						
RL Jones	198,547	37,575	(236,122) <sup>(3)</sup>	-	-	-
EG Tollitson <sup>(4)</sup>	103,813	26,981	(33,931)	(96,863)	-	-

(1) None of these options are vested or exercisable at 31 December 2006.

(2) These persons ceased being key management personnel from 1 July 2006.

(3) Mr Jones ceased employment on 31 October 2006. Under his termination arrangements, the vesting date of 151,877 DCP options was accelerated to his termination date. These options were exercised on 16 November 2006.

(4) Ms Tollitson ceased employment on 3 July 2006.

2005 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2005	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	FORFEITED/ CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2005 <sup>(1)</sup>	EXERCISE COST AT 31 DEC 2005 \$'000
<b>Executive director</b>						
FM O'Halloran	225,578	118,587	-	-	344,165	3,923
<b>Other key management personnel</b>						
SP Burns	226,244	163,522	-	-	389,766	3,828
NG Drabsch	130,780	67,350	-	-	198,130	2,260
TM Kenny	231,965	75,750	-	-	307,715	3,255
V McLenaghan	91,891	48,487	(19,794)	-	120,584	1,451
PE Grove	226,569	122,969	-	-	349,538	3,992
MD ten Hove	-	66,707	-	-	66,707	991
RL Jones	188,351	50,283	(40,087)	-	198,547	2,133
EG Tollitson	69,073	34,740	-	-	103,813	1,178

(1) None of these options are vested or exercisable at 31 December 2005.

## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED) CONTINUED

## (iii) Future performance options holdings

Details of the movements in the number of future performance options over ordinary shares in the company provided as remuneration to the key management personnel are provided below:

2006 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2006	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	FORFEITED/ CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2006	EXERCISE COST AT 31 DEC 2006 \$'000
<b>Key management personnel</b>						
SP Burns	115,000	–	(35,000)	–	80,000	582
TM Kenny	230,000	–	(50,000)	–	180,000 <sup>(1)</sup>	1,912
PE Grove	195,000	–	(135,000)	–	60,000	436

(1) 20,000 of these options were vested and exercisable at 31 December 2006.

2005 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2005	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	FORFEITED/ CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2005	EXERCISE COST AT 31 DEC 2005 \$'000
<b>Key management personnel</b>						
SP Burns	115,000	–	–	–	115,000	954
NG Drabsch	100,000	–	(100,000)	–	–	–
PE Grove	195,000	–	–	–	195,000 <sup>(2)</sup>	1,546
TM Kenny <sup>(1)</sup>	130,000	100,000	–	–	230,000 <sup>(3)</sup>	2,529
EG Tollifson	100,000	–	(100,000)	–	–	–

(1) 100,000 future performance options were granted to Mr Kenny on 12 May 2005 under the terms of an agreement entered into on 12 May 2000. The fair value of these options at grant date was \$2.32. The exercise price is \$14.81.

(2) 100,000 of these options had vested at 31 December 2006.

(3) 20,000 of these options had vested on 31 December 2006.

## (iv) Regular options holdings

Details of the movements in the number of regular options over ordinary shares in the company provided as remuneration to the key management personnel are provided below:

2006 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2006	EXERCISED IN THE YEAR	FORFEITED/ CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2006
<b>Key management personnel</b>				
V McLenaghan	750	(750)	–	–
<b>Former key management personnel<sup>(1)</sup></b>				
RL Jones	1,500	(1,500)	–	–
EG Tollifson	1,000	(1,000)	–	–

(1) These persons ceased being key management personnel from 1 July 2006.

2005 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2005	EXERCISED IN THE YEAR	FORFEITED/ CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2005 <sup>(1)</sup>	EXERCISE COST AT 31 DEC 2005 \$'000
<b>Key management personnel</b>					
TM Kenny	10,000	(10,000)	–	–	–
V McLenaghan	3,000	(2,250)	–	750	8
RL Jones	6,000	(4,500)	–	1,500	16
EG Tollifson	4,000	(3,000)	–	1,000	11

(1) None of the options had vested or were exercisable at 31 December 2005.

## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED) CONTINUED

(v) Conditional rights holdings

Details of the movements in the number of conditional rights to ordinary shares in the company provided as remuneration under the DCP to the key management personnel are provided below:

2006 NUMBER OF RIGHTS	BALANCE AT 1 JAN 2006	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2006 <sup>(1)</sup>
<b>Executive director</b>						
FM O'Halloran	138,038	35,539	4,811	(47,900)	–	130,488
<b>Other key management personnel</b>						
SP Burns	157,101	41,444	6,641	(33,784)	–	171,402
NG Drabsch	80,515	18,923	3,150	(26,947)	–	75,641
TM Kenny	126,366	25,870	4,449	(62,527)	–	94,158
V McLenaghan	48,602	14,678	2,138	(9,628)	–	55,790
PE Grove	142,043	35,945	5,625	(49,017)	–	134,596
MD ten Hove	26,039	17,549	1,587	–	–	45,175
<b>Former key management personnel<sup>(2)</sup></b>						
RL Jones	81,348	14,091	2,839	(98,278) <sup>(3)</sup>	–	–
EG Tollifson <sup>(4)</sup>	42,217	10,118	973	(14,658)	(38,650)	–

(1) None of these conditional rights are vested or exercisable at 31 December 2006.

(2) These persons ceased being key management personnel from 1 July 2006.

(3) Mr Jones ceased employment on 31 October 2006. Under his termination arrangements, the vesting date of 61,886 conditional rights was accelerated to this date.

(4) Ms Tollifson ceased employment on 3 July 2006.

2005 NUMBER OF RIGHTS	BALANCE AT 1 JAN 2005	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	BALANCE AT 31 DEC 2005 <sup>(1)</sup>
<b>Executive director</b>					
FM O'Halloran	89,033	44,470	4,535	–	138,038
<b>Other key management personnel</b>					
SP Burns	89,601	61,321	6,179	–	157,101
NG Drabsch	52,094	25,256	3,165	–	80,515
TM Kenny	92,990	28,406	4,970	–	126,366
V McLenaghan	36,922	18,183	2,083	(8,586)	48,602
PE Grove	90,342	46,116	5,585	–	142,043
MD ten Hove	–	25,015	1,024	–	26,039
RL Jones	76,332	18,856	3,548	(17,388)	81,348
EG Tollifson	27,530	13,027	1,660	–	42,217

(1) None of these conditional rights are vested or exercisable at 31 December 2005.

## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED) CONTINUED

(vi) Share holdings

The movements during the year in the number of ordinary shares in the company held by the key management personnel, including their personally related parties, are provided below:

2006 NUMBER OF SHARES	INTEREST IN SHARES AT 1 JAN 2006	CONDITIONAL RIGHTS VESTED	OPTIONS EXERCISED	PURCHASED (SOLD)	DIVIDENDS REINVESTED IN THE YEAR	INTEREST IN SHARES AT 31 DEC 2006	INTEREST IN SHARES AT 31 DEC 2006 SUBJECT TO NON-RECOURSE LOANS <sup>(5)</sup>
<b>Non-executive directors</b>							
LF Bleasel AM	43,403	–	–	–	300	43,703	–
EJ Cloney	734,917	–	–	(49,540)	–	685,377	–
The Hon NF Greiner AC	55,505 <sup>(1)</sup>	–	–	9,364	846	65,715	–
BJ Hutchinson	27,446	–	–	6,504	–	33,950	–
CLA Irby	15,000	–	–	–	–	15,000	–
IYL Lee	13,956	–	–	6,913	260	21,129	–
<b>Executive director</b>							
FM O'Halloran	1,079,602	47,900	110,884	(70,500)	18,709	1,186,595	1,074,043
<b>Other key management personnel</b>							
SP Burns	3,207	33,784	113,206	(146,892)	62	3,367	3,025
NG Drabsch	293,419	26,947	62,381	(64,671)	5,455	323,531	320,095
TM Kenny	13,022	62,527	194,747	(267,274)	613	3,635	–
V McLenaghan	228,746	9,628	23,037	(90,000)	–	171,411	140,646
PE Grove	2,970	49,017	248,470	(262,444)	55	38,068	38,025
MD ten Hove	330,494	–	–	(50,000)	5,958	286,452	284,760
<b>Former key management personnel<sup>(2)</sup></b>							
RL Jones	300,566	98,278	237,622	(556,309)	5,588	85,745 <sup>(3)</sup>	–
EG Tollitson	215,683	14,658	34,931	(80,000)	4,009	189,281 <sup>(4)</sup>	–

(1) Includes 10,000 warrants. These were converted to 12,500 ordinary shares in the company during the year.

(2) These persons ceased being key management personnel from 1 July 2006.

(3) Balance of ordinary shares held at 31 October 2006.

(4) Balance of ordinary shares held at 3 July 2006.

(5) Prior to 20 June 2005, non-recourse loans were provided by the consolidated entity to the executive director and other key management personnel on the exercise of their options for the purchase of shares in the company. Under AIFRS, non-recourse loans and the related shares are derecognised and are instead treated as options.

## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED) CONTINUED

The movements in the number of ordinary shares in the company held by the key management personnel, including their personally related parties, in the prior year are provided below:

2005 NUMBER OF SHARES	INTEREST IN SHARES AT 1 JAN 2005	CONDITIONAL RIGHTS VESTED	OPTIONS EXERCISED	PURCHASED (SOLD)	DIVIDENDS REINVESTED IN THE YEAR	INTEREST IN SHARES AT 31 DEC 2005	INTEREST IN SHARES AT 31 DEC 2005 SUBJECT TO NON-RECOURSE LOANS <sup>(3)</sup>
<b>Non-executive directors</b>							
LF Bleasel AM	42,768	—	—	—	635	43,403	—
EJ Cloney	720,410	—	—	(14,485)	28,992	734,917	—
CP Curran AO	356,751	—	—	—	1,162	357,913 <sup>(1)</sup>	—
The Hon NF Greiner AC	53,716	—	—	—	1,789	55,505 <sup>(2)</sup>	—
IF Hudson	—	—	—	—	—	—	—
BJ Hutchinson	27,446	—	—	—	—	27,446	—
CLA Irby	15,000	—	—	—	—	15,000	—
IYL Lee	10,467	—	—	3,000	489	13,956	—
<b>Executive director</b>							
FM O'Halloran	1,160,741	—	—	(124,000)	42,861	1,079,602	965,580
<b>Other key management personnel</b>							
SP Burns	3,083	—	—	—	124	3,207	2,970
NG Drabsch	256,067	—	100,000	(75,000)	12,352	293,419	287,371
PE Grove	2,854	—	—	—	116	2,970	2,970
MD ten Hove	376,296	—	—	(60,000)	14,198	330,494	328,833
RL Jones	228,076	17,388	44,587	—	10,515	300,566	282,830
TM Kenny	150,749	—	10,000	(150,749)	3,022	13,022	13,022
V McLenaghan	198,116	8,586	22,044	—	—	228,746	207,609
EG Tollifson	165,104	—	103,000	(60,000)	7,579	215,683	194,682

(1) Balance of ordinary shares held at 8 April 2005.

(2) Includes 10,000 warrants to purchase ordinary shares.

(3) Prior to 20 June 2005, non-recourse loans were provided by the consolidated entity to the executive director and other key management personnel on the exercise of their options for the purchase of shares in the company. Under AIFRS, non-recourse loans and the related shares are derecognised and are instead treated as options.

## (E) Key management personnel – share loans

Details regarding the share loans made by the consolidated entity to the key management personnel are set out below:

## (i) Non-recourse share loans

2006	BALANCE AT 1 JAN 2006 \$'000	LOANS MADE IN THE YEAR \$'000	REPAYMENTS \$'000	BALANCE AT 31 DEC 2006 \$'000	INTEREST NOT CHARGED \$'000	HIGHEST BALANCE IN PERIOD \$'000
<b>Executive director</b>						
FM O'Halloran	4,336	—	—	4,336	314	4,336
<b>Other key management personnel</b>						
SP Burns	22	—	—	22	2	22
NG Drabsch	2,438	—	(76)	2,362	172	2,438
TM Kenny	61	—	(63)	(2)	3	61
V McLenaghan	1,422	—	(249)	1,173	92	1,422
PE Grove	22	—	—	22	2	22
MD ten Hove	3,367	—	(107)	3,260	237	3,367
<b>Former key management personnel<sup>(1)</sup></b>						
RL Jones	2,326	—	(2,326)	—	141	2,326
EG Tollifson	1,631	—	(1,631)	—	75	1,631
<b>Total</b>	<b>15,625</b>	<b>—</b>	<b>(4,452)</b>	<b>11,173</b>	<b>1,038</b>	

(1) These persons ceased being key management personnel from 1 July 2006.



## KEY MANAGEMENT PERSONNEL (COMPANY AND CONSOLIDATED) CONTINUED

Prior to 20 June 2005, non-recourse loans were provided by the consolidated entity to the executive director and other key management personnel for the purchase of shares in the company. Under AIFRS, non-recourse loans and the related shares are derecognised and are instead treated as options.

## (iii) Personal recourse share loans

	BALANCE AT 1 JAN 2006 \$'000	LOANS MADE IN THE YEAR \$'000	REPAYMENTS \$'000	BALANCE AT 31 DEC 2006 \$'000	INTEREST NOT CHARGED \$'000	HIGHEST BALANCE IN PERIOD \$'000
<b>2006</b>						
<b>Executive director</b>						
FM O'Halloran	–	891	–	891	47	891
<b>Other key management personnel</b>						
SP Burns	–	373	(373)	–	7	373
NG Drabsch	–	502	–	502	29	502
TM Kenny	–	617	(617)	–	18	617
V McLenaghan	13	187	–	200	12	200
PE Grove	–	373	–	373	17	373
<b>Former key management personnel<sup>(1)</sup></b>						
RL Jones	26	693	(719)	–	36	719
EG Tollifson	17	284	(301)	–	11	301
<b>Total</b>	<b>56</b>	<b>3,920</b>	<b>(2,010)</b>	<b>1,966</b>	<b>177</b>	

(1) These persons ceased being key management personnel from 1 July 2006.

In 2005, there were no personal recourse loans to key management personnel that exceeded \$100,000 at any time.

Interest not charged in respect of personal recourse loans amounted to \$177,000 (2005 \$1,000).

## (F) Other transactions with key management personnel and their personally related parties

## FM O'Halloran – retirement benefits

Mr O'Halloran joined QBE in June 1976. Nine of his years with the consolidated entity have been in the position of chief executive officer, with four years as director of operations, seven years as director of finance, five years as chief financial officer and the remainder as Group financial controller. On 1 January 1998, a controlled entity entered into a retirement benefit arrangement with Mr O'Halloran, which is in addition to his entitlement under the QBE Australia defined benefit plan. As Mr O'Halloran was employed by the consolidated entity in May 2004, on his retirement he will receive a lump sum payment of 150% of his total remuneration cost being his annual base salary plus STI for the year prior to the date of his retirement. As a condition of this arrangement, Mr O'Halloran has entered into a non-compete agreement for three years from the date of his retirement.

## RETIREMENT BENEFITS

Entities in the consolidated entity participate in a number of superannuation plans which have been established and are sponsored by those entities. A number of these plans provide defined benefits to employees on retirement, disability or death. The benefits are based on years of service and an average salary calculation.

Contributions are made to the plans by both employees and controlled entities, typically as a percentage of salary and within the rules of the plans, and are based on funding schedules prepared by independent actuaries. In addition, the consolidated entity continues to meet applicable statutory minimum funding requirements set out by legislation in the UK. The contribution rate in respect of defined benefit plans is agreed between the relevant controlled entity and the plans' trustees and actuaries. The consolidated entity has no immediate legal obligation to settle the liability.

Independent actuarial assessments of all significant plans are completed at least once every three years. The main plans were assessed by various qualified employees of Russell Employee Benefits, AON Consulting, Watson Wyatt Worldwide and Mercers. All valuations have been updated for information available at 31 December 2006.

## RETIREMENT BENEFITS CONTINUED

## (A) Balance sheet amounts

The amounts recognised in the balance sheet for defined benefit superannuation plans are as follows:

	DATE OF LAST FULL ACTUARIAL REVIEW	FAIR VALUE OF PLAN ASSETS		PRESENT VALUE OF PLAN OBLIGATIONS		NET SURPLUS (DEFICIT)	
		2006 \$M	2005 \$M	2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>Retirement benefit surplus</b>							
New Zealand superannuation plan	31 Dec 04	8	7	(6)	(5)	2	2
<b>Retirement benefit deficit</b>							
QBE Australia defined benefit plan	31 Dec 05	70	63	(70)	(71)	-	(8)
Iron Trades insurance staff trust	31 Dec 04	357	279	(355)	(349)	2	(70)
European staff retirement benefit plan	1 Jan 05	16	13	(16)	(21)	-	(8)
Janson Green final salary superannuation scheme	31 Dec 04	240	162	(234)	(237)	6	(75)
National Farmers Union	31 Dec 06	30	31	(33)	(34)	(3)	(3)
Other plans		6	5	(11)	(9)	(5)	(4)
		719	553	(719)	(721)	-	(168)
Surplus not recognised						(8)	-
						(8)	(168)

## (B) Reconciliation

	2006 \$M	2005 \$M
<b>Fair value of plan assets at 1 January</b>	560	498
Expected return on plan assets	36	30
Actuarial (losses) gains on plan assets	(9)	39
Employer contributions	140	87
Contributions by plan participants	1	1
Benefits and expenses paid	(23)	(32)
Transfer of assets from closed fund	-	(80)
Curtailments and settlements	-	3
Acquisitions	-	30
Foreign exchange	22	(16)
<b>Fair value of plan assets at 31 December</b>	727	560
<b>Wholly funded defined benefit obligation at 1 January</b>	(726)	(698)
Current service cost	(8)	(16)
Interest cost	(34)	(35)
Actuarial gains (losses)	21	(75)
Benefits and expenses paid	23	32
Past service cost	-	(1)
Contributions by plan participants	(1)	(1)
Transfer of defined benefit obligation from closed fund	-	80
Curtailments and settlements	30	(1)
Acquisitions	-	(34)
Foreign exchange	(30)	23
<b>Wholly funded defined benefit obligation at 31 December</b>	(725)	(726)
Net surplus (deficit) at 31 December	2	(166)
Surplus not recognised	(8)	-
<b>Net liability recognised in the balance sheet at 31 December</b>	(6)	(166)

## RETIREMENT BENEFITS CONTINUED

	2006 \$M	2005 \$M
<b>Net liability recognised in the balance sheet at 1 January</b>	<b>(166)</b>	<b>(200)</b>
Amounts recognised in the income statement		
Current service cost	(8)	(16)
Interest cost	(34)	(35)
Past service cost	-	(1)
Expected return on plan assets	36	30
Curtailments and settlements	30	2
	24	(20)
Actuarial gains (losses) included in the statement of recognised income and expense	12	(36)
Employer contributions	140	87
Acquisitions	-	(4)
Foreign exchange	(8)	7
Net surplus (deficit) at 31 December	2	(166)
Surplus not recognised	(8)	-
<b>Net liability recognised in the balance sheet at 31 December</b>	<b>(6)</b>	<b>(166)</b>

The credit recognised in the income statement in the year of \$24 million (2005 \$20 million charge) has been included within underwriting expenses. The actual return on plan assets was \$27 million (2005 \$69 million).

## (C) Amounts included in the statement of recognised income and expense

Cumulative actuarial gains and losses included in the statement of recognised income and expense are as follows:

	2006 \$M	2005 \$M
<b>Actuarial losses at 1 January</b>	<b>71</b>	<b>35</b>
Actuarial (gains) losses recognised in the year	(5)	36
<b>Actuarial losses at 31 December</b>	<b>66</b>	<b>71</b>
<b>Deferred taxation on actuarial losses at 1 January</b>	<b>(19)</b>	<b>(10)</b>
Deferred taxation credit on actuarial losses recognised in the year	1	(9)
<b>Deferred taxation on actuarial losses at 31 December</b>	<b>(18)</b>	<b>(19)</b>
<b>Net actuarial losses at 31 December</b>	<b>48</b>	<b>52</b>

## (D) Principal actuarial assumptions

	2006 %	2005 %
Discount rate	4.0 – 5.8	3.9 – 6.1
Expected return on plan assets	5.3 – 8.0	5.2 – 8.0
Future salary increases	3.0 – 6.0	3.5 – 6.0
Future pension increases	2.0 – 3.0	0.0 – 2.8

The expected return on plan assets is based on historical and future expectations of returns for each of the major asset classes as well as the expected and actual allocation of plan assets to these major classes.

## (E) Analysis of plan assets

	2006 \$M	2005 \$M
Equities	166	195
Bonds	512	319
Property	1	1
Other	48	45
	<b>727</b>	<b>560</b>

## RETIREMENT BENEFITS CONTINUED

## (F) Historical summary

	2006 \$M	2005 \$M	2004 \$M
Experience gains (losses) arising on plan liabilities	9	(6)	(42)
Experience (losses) gains arising on plan assets	(9)	39	7

	2006 \$M	2005 \$M	2004 \$M
Present value of plan obligations	(725)	(726)	(698)
Fair value of plan assets	727	560	498
Net surplus (deficit)	2	(166)	(200)

## (G) Funding

Employer contributions to the defined benefit superannuation plans are based on recommendations by the plans' actuaries. The objective of the consolidated entity's funding schedules is to ensure that benefit entitlements are fully funded at the time they become payable. The key economic assumptions applied by the actuaries are shown in note 29(D).

## REMUNERATION OF AUDITORS

	2006 \$'000	2005 \$'000
<b>PricewaterhouseCoopers – Australian firm<sup>(1)</sup></b>		
Audit or review of financial reports of the parent entity	1,642	754
Audit of financial reports of controlled entities	2,618	2,251
Audit of statutory returns	620	442
Other audit assurance services	451	430
Taxation services	249	233
Actuarial services	130	–
Advisory services (including business continuity management assistance)	134	151
	<b>5,844</b>	<b>4,261</b>
<b>Related practices of PricewaterhouseCoopers – Australian firm<sup>(1)</sup></b> (including overseas PricewaterhouseCoopers firms)		
Audit of financial reports of controlled entities	8,355	5,235
Audit of statutory returns	1,636	1,882
Other audit assurance services	475	15
Taxation services	310	427
Advisory services (including due diligence services)	663	1,001
Actuarial services	265	–
Systems services	44	–
	<b>11,748</b>	<b>8,560</b>
	<b>17,592</b>	<b>12,821</b>
Audit and assurance services	<b>15,797</b>	<b>11,009</b>
Other services	<b>1,795</b>	<b>1,812</b>
	<b>17,592</b>	<b>12,821</b>
<b>Other auditors</b>		
Audit of financial reports of controlled entities	<b>239</b>	<b>410</b>

(1) From 1 January 2003, the consolidated entity may engage PricewaterhouseCoopers for non-audit services, subject to the general principle that fees for non-audit services should not exceed 30% of the total of all fees in any one year. Consistent with prior periods, PricewaterhouseCoopers cannot provide the excluded services of preparing accounting records or financial reports, asset or liability valuations, acting in a management capacity, acting as a custodian of assets or acting as share registrar.

# 31

## CONTINGENT LIABILITIES

The company and the consolidated entity had the following contingent liabilities:

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Guarantees of interest bearing liabilities in controlled entities	399	427	-	-
Letters of credit issued in support of the consolidated entity's participation in Lloyd's of London	372	352	372	352
Letters of credit issued in support of insurance provisions of controlled entities	246	237	-	-
Guarantees to investors in hybrid securities	558	701	-	-
Guarantees to investors in ABC securities for funds at Lloyd's (due 2008)	696	750	-	-
Guarantees to investors in ABC securities for funds at Lloyd's (due 2009)	279	300	-	-
Guarantees to investors in capital securities	744	-	-	-

A controlled entity has entered into a number of deeds of covenant in respect of its controlled entities to meet part of their obligations to Lloyd's of London. The total guarantee given under these deeds of covenant amounts to \$344 million (2005 \$316 million). The obligations under the deeds of covenant are secured by a fixed and floating charge over certain investments and other assets in favour of Lloyd's of London. Refer note 11(C).

Details of the guarantees to investors in Eurobonds, hybrid securities and capital securities and security arrangements in respect of interest bearing liabilities are provided in note 24.

Details of contingent liabilities in respect of ABC securities for funds at Lloyd's are included in note 34(C).

# 32

## CAPITAL EXPENDITURE COMMITMENTS

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Capital expenditure commitments contracted but not provided for in the financial statements (not later than one year)	-	-	-	14

# 33

## OPERATING LEASE COMMITMENTS

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Payable:				
Not later than one year	-	-	50	42
Later than one year but not later than five years	-	-	163	124
Later than five years	-	-	421	181
<b>Total future minimum lease payments under cancellable operating leases</b>	-	-	<b>634</b>	<b>347</b>

## LLOYD'S DIVISION

## (A) Non-aligned syndicates

A controlled entity acquired Limit plc and its controlled entities ("Limit") in August 2000. From 1994 to 2000, Limit participated in the results of a number of syndicates managed by other managing agents at Lloyd's (non-aligned syndicates). In 2000, Limit sold its right to participate in the results of non-aligned syndicates after 31 December 2000. In 2001, Limit sold the rights to manage syndicate 318, previously managed by its controlled managing agency, to another managing agency at Lloyd's but retained participation in the syndicate until December 2004. The result of Limit's participation on this syndicate has also been included as non-aligned. Lloyd's operates on a three year accounting basis and at the end of the third year the underwriting account is normally closed by reinsurance into the following year of account. The runoff of these syndicates is expected to complete by 31 March 2010. The consolidated entity is expected to have to fund its share of the net outstanding claims of these operations, as shown below, and therefore the assets and liabilities are included on a net basis in outstanding claims in the balance sheet.

	2006 \$M	2005 \$M
<b>Assets</b>		
Financial assets – market value	131	120
Other assets	125	115
	<b>256</b>	<b>235</b>
<b>Liabilities</b>		
Outstanding claims net of reinsurance recoveries	302	277
Other liabilities	14	13
	<b>316</b>	<b>290</b>
<b>Net liabilities</b>	<b>60</b>	<b>55</b>

## (B) Reinsurance to close

Since acquiring Limit in August 2000, the consolidated entity has purchased additional capacity in the syndicates managed by Limit, taking its ownership share for all syndicates from 55% in 2000 to 91% for the 2007 underwriting year. These purchases of additional capacity create an obligation for the consolidated entity to accept the additional share of insurance provisions in exchange for an equal amount of investments and other assets. The amounts will be determined when the reinsurance to close is calculated on 31 December 2007 or subsequent dates. It is currently estimated that the amount of the net insurance provisions and matching assets will exceed \$22 million, which will be recognised in the years in which the reinsurance to close is expected to be finalised.

## (C) Funds at Lloyd's

## (i) ABC securities (due 2009)

In October 2004, the company entered into an arrangement with Mantis Reef II Limited ("MR(II)L") to issue US\$220 million of ABC (asset backed capital) securities to support funds at Lloyd's ("FAL") pursuant to Lloyd's collateral requirements. This arrangement substantially replaced bank letters of credit and assisted in meeting new FAL requirements. MR(II)L is a special purpose entity incorporated with limited liability under the laws of the Cayman Islands. The consolidated entity has no ownership interest in MR(II)L.

Proceeds from the sale of the ABC securities to investors have been swapped to sterling and then used to purchase shares in a wholly owned controlled entity of MR(II)L, Mantis Reef II Pledge Limited ("MR(II)PL"). MR(II)PL is another special purpose entity incorporated with limited liability under the laws of the Cayman Islands. The proceeds from the sale of shares in MR(II)PL have been used to purchase eligible investments over which security interests, in the form of a fixed and floating charge, have been granted to Lloyd's in support of FAL requirements of some of the company's controlled entities. Details of the eligible investments included in the asset portfolio are shown below as ABC financial assets pledged for funds at Lloyd's.

Under its arrangement with MR(II)L and MR(II)PL, the company makes fixed payments to MR(II)L and in return receives the benefit of the earnings from the investment portfolio. As part of its agreement with MR(II)L and MR(II)PL the company can, if the need arises, call on MR(II)PL to provide up to £120 million by the sale or transfer of its investment portfolio to meet certain controlled entities' cash call requirements from Lloyd's, and at that time the company would assume a loan obligation including servicing of interest payments and repayment of the principal. To achieve this, the company would issue debt securities to MR(II)L with similar terms to the ABC securities. The company has entered into a fixed for floating cross currency interest rate swap with a third party to service its fixed interest rate obligations.

## (ii) ABC securities (due 2008)

In October 2003, the company entered into an arrangement with Mantis Reef Limited ("MRL") to issue US\$550 million of ABC securities to support FAL pursuant to Lloyd's collateral requirements. This arrangement substantially replaced bank letters of credit. MRL is a special purpose entity incorporated with limited liability under the laws of the Cayman Islands. The consolidated entity has no ownership interest in MRL.

## LLOYD'S DIVISION CONTINUED

Proceeds from the sale of the ABC securities to investors have been used to purchase shares in a wholly owned controlled entity of MRL, Mantis Reef Pledge Limited ("MRPL"). MRPL is another special purpose entity incorporated with limited liability under the laws of the Cayman Islands. The proceeds from the sale of shares in MRPL have been used to purchase eligible investments over which security interests, in the form of a fixed and floating charge, have been granted to Lloyd's in support of FAL requirements. Details of the eligible investments included in the asset portfolio are shown below as ABC financial assets pledged for funds at Lloyd's.

Under its arrangement with MRL and MRPL, the company makes fixed payments to MRL and in return receives the benefit of the earnings from the investment portfolio. As part of its agreement with MRL and MRPL the company can, if the need arises, call on MRPL to provide up to US\$550 million by the sale or transfer of its investment portfolio to meet certain controlled entities' cash call requirements from Lloyd's, and at that time the company would assume a loan obligation including servicing of interest payments and repayment of the principal. To achieve this, the company would issue debt securities to MRL with similar terms to the ABC securities. The company has entered into a fixed for floating interest rate swap with a third party to service its fixed interest rate obligations.

## (iii) Swaps relating to ABC securities

The consolidated entity is exposed to interest rate and currency risk in respect of the ABC securities and has therefore entered into two swap agreements, being an interest rate swap agreement with a financial institution under which it is obliged to pay interest at a variable rate and receive interest at a fixed rate and a cross currency interest rate swap agreement under which it is obliged to pay variable rate interest on a sterling asset portfolio and receive a fixed amount of US dollar interest.

ABC securities (due 2009) are measured at amortised cost in original currency and translated to Australian dollars at the closing rate of exchange. Under the swap agreement, the consolidated entity pays a margin of 1.7% above the wholesale interbank rate monthly on £120 million and receives a fixed rate of 3.2% on US\$220 million every six months to match the interest payment to investors. The swap agreement currently comprises three swaps which are measured at fair value. Two of the swaps are designated as cash flow hedges and have satisfied the effectiveness tests throughout the period from inception and at the balance date. The movement in the fair value of the cash flow hedges is taken to equity. Any ineffectiveness in the cash flow hedges is recognised directly in the income statement. An amount is transferred from equity and taken to the income statement to offset:

- the differential between the fixed and variable interest payments; and
- the foreign exchange gain or loss on translation of the financial liabilities.

During the year, a loss of \$34 million (2005 loss of \$1 million) was recognised in equity relating to the fair value movements on the cash flow hedges. During the year, a loss of \$41 million (2005 gain of \$4 million) was transferred from equity to the income statement.

ABC securities (due 2008) are measured at amortised cost in original currency and translated to Australian dollars at the closing rate of exchange. Under the swap agreement, the consolidated entity pays interest at the wholesale interbank rate and receives a fixed rate of 3.5% on US\$550 million every six months to match the interest payment to investors.

The swap agreement comprises two swaps which are measured at fair value. The swaps are designated as fair value hedges and have satisfied the relevant hedge effectiveness tests throughout the period and at the balance date. The fair value movement on the swaps is recognised in the income statement. Any change in the value of the financial liabilities as a result of the hedged risk adjusts the carrying amount of the hedged item and impacts the income statement.

			THE COMPANY		CONSOLIDATED	
			2006 \$M	2005 \$M	2006 \$M	2005 \$M
<b>ABC financial assets pledged for funds at Lloyd's</b>						
Due 2008	Interest bearing short term money	US\$550 million	—	—	696	750
Due 2009	Interest bearing short term money	£120 million	—	—	299	282
			—	—	995	1,032
<b>ABC securities for funds at Lloyd's</b>						
Due 2008		US\$550 million	—	—	671	720
Due 2009		US\$220 million	—	—	275	295
			—	—	946	1,015
Swaps relating to ABC securities			5	5	58	29
			5	5	1,004	1,044



## LLOYD'S DIVISION CONTINUED

		2006 \$M	2005 \$M
<b>Fair value of ABC securities for funds at Lloyd's</b>			
Due 2008	US\$550 million	687	724
Due 2009	US\$220 million	260	288
		947	1,012

## RELATED PARTIES (COMPANY AND CONSOLIDATED)

All material information required to be disclosed under AASB 124: Related Party Disclosures has been included in the financial statements as follows:

## REFERENCE

Dividends from controlled entities	Note 7(B)
Amounts due from controlled entities	Note 13
Investments in controlled entities	Note 18
Amounts due to controlled entities	Note 20
Tax sharing agreement	Note 8(B)
Remuneration of key management personnel	Directors' report and note 28
Retirement allowances of key management personnel	Directors' report
Shares and options held by key management personnel	Note 28
Related party transactions with key management personnel	Note 28
Retirement benefits	Note 29
Guarantees in respect of related parties	Note 31

In the ordinary course of business, various controlled entities receive dividends and purchase and sell investments in public entities in which directors of the company are directors and shareholders.

## EARNINGS PER SHARE (CONSOLIDATED)

	2006 CENTS	2005 CENTS
Basic earnings per share	186.4	144.3
Diluted earnings per share	178.5	135.0

	\$M	\$M
(A) Reconciliation of earnings used in calculating earnings per share		
Net profit after income tax attributable to members of the company, used in calculating basic earnings per share	1,483	1,091
Add: finance costs of hybrid securities	3	6
Earnings used in calculating diluted earnings per share	1,486	1,097

## EARNINGS PER SHARE (CONSOLIDATED) CONTINUED

	2006 MILLION	2005 MILLION
(B) Reconciliation of weighted average number of ordinary shares used in calculating earnings per share		
Weighted average number of ordinary of shares on issue	802	766
Weighted average number of non-recourse loan shares issued under the Plan	(6)	(9)
Weighted average number of treasury shares held in trust	(1)	-
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share <sup>(1)</sup>	795	757
Weighted average number of dilutive potential ordinary shares relating to:		
Shares issued under the Plan	6	9
Options issued under the Plan	4	4
Hybrid securities <sup>(2)</sup>	26	43
Unvested conditional rights supported by treasury shares held in trust	1	-
Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share	832	813

(1) Weighted average number of ordinary shares reflects shares adjusted to derecognise shares issued under the Plan. Basic earnings per share calculated with reference to issued share capital notified to the ASX would have been 184.8 cents (2005 142.5 cents). Refer to note 25(A).

(2) Hybrid securities have been treated as dilutive if the contingent conversion conditions are met at the balance date. If all hybrid securities had been considered dilutive at 31 December 2006, diluted earnings per share would have been 173.5 cents (2005 131.5 cents).

## SEGMENT INFORMATION

## (A) Business segments

	AUSTRALIA PACIFIC ASIA CENTRAL EUROPE \$M	EUROPEAN OPERATIONS \$M	THE AMERICAS \$M	EQUATOR RE \$M	ELIMINATION \$M	TOTAL \$M
2006						
Total assets	8,138	20,277	3,220	1,526	(1,404)	31,757
Total liabilities	6,246	16,703	2,689	1,174	(1,404)	25,408
Acquisition of property, plant and equipment, intangibles and other non-current segment assets	93	8	60	-	-	161
Depreciation expense	16	21	5	-	-	42
Other non-cash expenses	-	7	1	-	-	8
Total revenue	3,554	6,319	2,240	736	(678)	12,171
Gross written premium	3,218	5,213	1,941	901	(901)	10,372
Gross earned premium	3,132	5,061	1,876	678	(678)	10,069
Outward reinsurance premium expense	(518)	(1,208)	(723)	(140)	678	(1,911)
Net earned premium	2,614	3,853	1,153	538	-	8,158
Net claims incurred	(1,381)	(2,184)	(644)	(342)	-	(4,551)
Net commission	(358)	(661)	(295)	(70)	-	(1,384)
Underwriting and other expenses	(436)	(466)	(95)	(26)	-	(1,023)
Underwriting result	439	542	119	100	-	1,200
Investment income on policyholders' funds	184	329	41	34	-	588
Insurance profit	623	871	160	134	-	1,788
Investment income on shareholders' funds	31	182	7	14	-	234
Amortisation of intangibles	(2)	(6)	(2)	-	-	(10)
Profit before income tax	652	1,047	165	148	-	2,012
Income tax expense	(170)	(288)	(54)	(7)	-	(519)
Profit after income tax	482	759	111	141	-	1,493
Net profit attributable to minority interest	(8)	-	(2)	-	-	(10)
Net profit after income tax attributable to members of the company	474	759	109	141	-	1,483

Intersegment transactions are priced on an arm's length basis and are eliminated on consolidation. Further information regarding the consolidated entity's business segments is included on pages 24 to 43 of the annual report.

## SEGMENT INFORMATION CONTINUED

2005	AUSTRALIA PACIFIC ASIA CENTRAL EUROPE \$M	EUROPEAN OPERATIONS \$M	THE AMERICAS \$M	EQUATOR RE \$M	ELIMINATION \$M	TOTAL \$M
Total assets	8,056	18,412	3,107	956	(866)	29,665
Total liabilities	6,060	15,835	2,717	760	(866)	24,506
Acquisition of property, plant and equipment, intangibles and other non-current segment assets	81	306	61	-	-	448
Depreciation expense	16	21	3	-	-	40
Other non-cash expenses	1	2	-	-	-	3
Total revenue	3,372	6,944	2,086	373	(347)	12,428
Gross written premium	3,122	4,794	1,492	353	(353)	9,408
Gross earned premium	3,093	4,643	1,435	347	(347)	9,171
Outward reinsurance premium expense	(542)	(946)	(592)	(52)	347	(1,785)
Net earned premium	2,551	3,697	843	295	-	7,386
Net claims incurred	(1,349)	(2,326)	(506)	(236)	-	(4,417)
Net commission	(356)	(651)	(215)	(29)	-	(1,251)
Underwriting and other expenses	(420)	(428)	(62)	-	-	(910)
Underwriting result	426	292	60	30	-	808
Investment income on policyholders' funds	181	253	27	19	-	480
Insurance profit	607	545	87	49	-	1,288
Investment income on shareholders' funds	50	171	10	7	-	238
Amortisation of intangibles	(1)	(2)	-	-	-	(3)
Profit before income tax	656	714	97	56	-	1,523
Income tax expense	(187)	(187)	(34)	(17)	-	(425)
Profit after income tax	469	527	63	39	-	1,098
Net profit attributable to minority interest	(6)	-	(1)	-	-	(7)
Net profit after income tax attributable to members of the company	463	527	62	39	-	1,091

Intersegment transactions are priced on an arm's length basis and are eliminated on consolidation.

## SEGMENT INFORMATION CONTINUED

## (B) External product segments

	DIRECT AND FACULTATIVE		INWARD REINSURANCE		TOTAL	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Total revenue	10,559	9,944	1,612	2,484	12,171	12,428
Net profit after income tax attributable to members of the company	1,382	1,116	101	(25)	1,483	1,091
Total assets	25,598	23,130	6,159	6,535	31,757	29,665
Acquisition of property, plant and equipment, intangibles and other non-current segment assets	130	349	31	99	161	448

## (C) Geographical analysis

		AUSTRALIA	ASIA-PACIFIC	EUROPE	THE AMERICAS	OTHER	TOTAL
		\$M	\$M	\$M	\$M	\$M	\$M
Total revenue	2006	3,158	750	3,314	4,007	942	12,171
	2005	3,318	922	3,592	3,632	964	12,428
Net profit after income tax attributable to members of the company	2006	442	168	406	242	225	1,483
	2005	404	140	418	68	61	1,091
Total assets	2006	8,020	1,836	10,240	8,744	2,917	31,757
	2005	7,917	1,975	11,003	7,730	1,040	29,665
Acquisition of property, plant and equipment, intangibles and other non-current segment assets	2006	79	5	17	60	-	161
	2005	81	-	170	197	-	448

Profit and loss amounts are allocated to a geographical region based on the location of the risk or, when this information is not available, based on the location where the risk was underwritten.

Assets are allocated to a geographical region based on the location of the relevant risk where appropriate, or based on the location of the asset.

# RECONCILIATION OF CASH FLOWS FROM OPERATING ACTIVITIES TO NET PROFIT AFTER INCOME TAX ATTRIBUTABLE TO MEMBERS OF THE COMPANY

	THE COMPANY		CONSOLIDATED	
	2006 \$M	2005 \$M	2006 \$M	2005 \$M
Cash flows from operating activities	1,086	187	2,039	1,987
Depreciation of assets	-	-	(42)	(40)
Amortisation and impairment of goodwill/intangibles	-	-	(10)	(3)
Amortisation of premium/discount on fixed interest securities	-	-	1	(9)
Profit (loss) on sale of controlled entities	16	629	(1)	11
Loss on sale of plant and equipment	-	-	(6)	(5)
Net foreign exchange (losses) gains	(12)	(5)	18	3
Other gains on financial assets	-	-	213	219
Increase in net outstanding claims	-	-	(411)	(836)
Increase in unearned premium	-	-	(362)	(236)
Increase in deferred insurance costs	-	-	57	62
Increase in net amounts receivable from controlled entities	759	267	-	-
Increase in trade debtors	-	-	35	350
Increase in other operating assets	380	26	85	17
(Decrease) increase in trade and other payables	-	-	161	(263)
Decrease (increase) in current tax liabilities	43	(60)	(47)	(85)
(Increase) decrease in deferred tax liabilities	16	16	(271)	(139)
(Increase) decrease in provisions	(9)	-	34	65
Minority interest	-	-	(10)	(7)
<b>Net profit after income tax attributable to members of the company</b>	<b>2,279</b>	<b>1,060</b>	<b>1,483</b>	<b>1,091</b>

## EVENTS OCCURRING AFTER THE BALANCE DATE

In December 2006, the consolidated entity announced its purchase of Praetorian Financial Group, a property and casualty insurer in the US. The purchase is subject to regulatory approvals and is expected to complete early in the second quarter of 2007. The purchase price is US\$0.8 billion and the fair value of net tangible assets at the date of acquisition is expected to be around US\$0.46 billion.

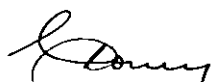
Since 31 December 2006, the consolidated entity has announced its purchase of Winterthur US Holdings, Inc., a property and casualty insurer in the US. The purchase is subject to regulatory approvals and is expected to complete during the second quarter of 2007. The purchase price is US\$1.16 billion and the fair value of net tangible assets at the date of acquisition is expected to be US\$0.78 billion.

In the directors' opinion:

- (a) the financial statements and notes set out on pages 70 to 137 are in accordance with the *Corporations Act 2001*, including:
  - (i) complying with accounting standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and
  - (ii) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2006 and of their performance, as represented by the results of their operations, changes in equity and their cash flows, for the financial year ended on that date; and
- (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable; and
- (c) the audited remuneration disclosures set out on pages 57 to 67 of the directors' report comply with Accounting Standard AASB 124: Related Party Disclosures and the Corporations Regulations 2001.

The directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A of the *Corporations Act 2001* for the financial year ended 31 December 2006.

Signed in SYDNEY this 23rd day of February 2007 in accordance with a resolution of the directors.



**EJ Cloney**  
Director



**FM O'Halloran**  
Director

## Audit opinion

In our opinion:

1. the financial report of QBE Insurance Group Limited:

- gives a true and fair view, as required by the *Corporations Act 2001* in Australia, of the financial position of QBE Insurance Group Limited and the QBE Insurance Group (defined below) as at 31 December 2006, and of their performance for the year ended on that date; and
- is presented in accordance with the *Corporations Act 2001*, accounting standards and other mandatory financial reporting requirements in Australia, and the *Corporations Regulations 2001*; and

2. the audited remuneration disclosures that are contained in pages 57 to 67 of the directors' report comply with Accounting Standard AASB 124 Related Party Disclosures ("AASB 124") and the *Corporations Regulations 2001*.

This opinion must be read in conjunction with the rest of our audit report.

## Scope

The financial report, remuneration disclosures and directors' responsibility

The financial report comprises the balance sheet, income statement, cash flow statement, statement of recognised income and expenses, accompanying notes to the financial statements and the directors' declaration for both QBE Insurance Group Limited ("the company") and the QBE Insurance Group ("the consolidated entity"), for the year ended 31 December 2006. The consolidated entity comprises both the company and the entities it controlled during that year.

The company has disclosed information about the remuneration of key management personnel ("remuneration disclosures") as required by AASB 124, under the heading "remuneration report" on pages 57 to 67 of the directors' report, as permitted by the *Corporations Regulations 2001*.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for the remuneration disclosures contained in the directors' report.

## Audit approach

We conducted an independent audit in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards, in order to provide reasonable assurance as to whether the financial report is free of material misstatement and the remuneration disclosures comply with AASB 124 and the *Corporations Regulations 2001*. The nature of an audit is influenced by factors such as the use of professional judgment, selective testing, the inherent limitations of internal controls and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected. For further explanation of an audit, visit our website <http://www.pwc.com/au/financialstatementaudit>.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001*, accounting standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations, changes in equity and cash flows. We also performed procedures to assess whether the remuneration disclosures comply with AASB 124 and the *Corporations Regulations 2001*.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis information to provide evidence supporting the amounts and disclosures in the financial report and remuneration disclosures; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

Our procedures include reading the other information in the annual report to determine whether it contains any material inconsistencies with the financial report.

Whilst we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

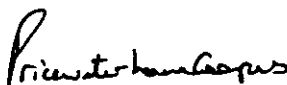
Our audit did not involve an analysis of the prudence of business decisions made by directors or management.

## Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*.



**RD Deutsch**  
Partner



**PricewaterhouseCoopers**

Sydney  
23 February 2007

Liability limited by a Scheme approved under Professional Standards Legislation.

OBE is incorporated in Australia, is listed on the Australian Stock Exchange ("ASX") and trades under the code "QBE".

#### **Annual General Meeting ("AGM")**

11:00am Wednesday, 4 April 2007

The Westin Hotel, 1 Martin Place, Sydney NSW Australia

Online proxy voting is available through the Link investor service centre website.

#### **Voting rights of ordinary shares**

The constitution provides for votes to be cast:

- on a show of hands, one vote for each shareholder; and
- on a poll, one vote for each fully paid ordinary share.

#### **Shareholder information and enquiries**

Most enquiries and correspondence regarding shareholdings can be directed to QBE's share registrar:

Link Market Services Limited

Locked Bag A14, Sydney South NSW 1235 Australia

Level 12, 680 George Street, Sydney NSW 2000 Australia

Telephone: +61 2 8280 7158 Facsimile: +61 2 9287 0303

Internet: [www.linkmarketservices.com.au](http://www.linkmarketservices.com.au) (link investor service centre website)

Email: [registrars@linkmarketservices.com.au](mailto:registrars@linkmarketservices.com.au)

For security purposes, please quote your Securityholder Reference Number ("SRN") or Holder Identification Number ("HIN").

If you are broker (CHESS) sponsored, queries relating to incorrect registrations and changes to name and/or address can only be processed by your stockbroker. Link Market Services ("Link") cannot assist you with these changes. Please quote your HIN.

#### **Relevant interests register**

Orient Capital Pty Limited of Level 12, 680 George Street, Sydney NSW 2000, Australia maintains QBE's register of information about relevant interests. The register contains any responses from custodians on and after 1 January 2005 to searches relating to the beneficial ownership of QBE's shares. Shareholders and other parties can telephone Orient Capital on +61 2 8280 6000 or facsimile on +61 2 8280 6001 if they wish to inspect this register.

#### **Shareholding details online**

View your shareholdings and update your details online at the Link investor service centre website. You will be asked to provide either your SRN or HIN, your surname and postcode.

You may receive dividend statements, notices of meetings, annual reports and major company announcements electronically by registering your email address at the Link investor service centre website.

#### **Removal from annual report mailing list**

If you do not wish to receive a copy of the annual report, please notify Link in writing or select "communication options" on the Link investor service centre website.

The half yearly results summary to 30 June 2007 will be mailed with the interim dividend. The next annual report for the year ending 31 December 2007 will be distributed in March 2008. QBE does not produce a concise financial report.



#### Tax File Number ("TFN"), Australian Business Number ("ABN") or exemption – Australian residents

You can confirm whether you have lodged your TFN, ABN or exemption by visiting the Link investor service centre website. If you choose not to lodge these details, QBE is obliged to deduct tax at the highest marginal rate (plus the Medicare levy) from the unfranked portion of dividends paid. Australian shareholders living abroad should advise Link of their resident status as limited exemptions to tax deductions may apply. TFN forms are available from Link or can be downloaded from either the QBE or Link websites.

#### Dividends

QBE encourages shareholders to have cash dividends credited directly to a bank, building society or credit union account in Australia or New Zealand to eliminate delays in funds clearance and to significantly reduce the risk of loss or theft. A dividend advice confirming the deposit details is either mailed to you or is available online on the payment date.

Eligible shareholders can choose to participate in QBE's Dividend Reinvestment Plan ("DRP") and Dividend Election Plan ("DEP").

The DRP enables you to apply to subscribe for additional shares. The DEP is a bonus share plan whereby the dividend entitlement is forgone for bonus shares in lieu of the dividend. In order to participate in either DRP or DEP, you must have a minimum shareholding of 100 shares.

Participants may change their election to participate in the DRP and DEP at any time. DRP/DEP election cut-off dates and application forms are available from QBE's website.

#### Unpresented cheques/unclaimed monies

Under the *Unclaimed Moneys Act 1962*, unclaimed dividends must be given to the state treasury. It is very important that shareholders bank outstanding dividend cheques promptly and advise Link immediately of changes of address or bank account details.

#### Privacy legislation

Chapter 2C of the *Corporations Act 2001* requires information about you as a security holder (including your name, address and details of the securities you hold) to be included in QBE's share register. These details must continue to be included in the public register even if you cease to be a security holder. A copy of the privacy policy is available on Link's website.

#### Registered office

QBE Insurance Group Limited

Level 2, 82 Pitt Street, Sydney NSW 2000 Australia

Telephone: +61 2 9375 4444 Facsimile: +61 2 9235 3166

Internet: [www.qbe.com](http://www.qbe.com)

#### QBE website

QBE's website provides investors with information about QBE including annual reports, half yearly reports and announcements to the ASX. The website also offers regular QBE share price updates, a calendar of events, a brief history of QBE's dividends, access to standard forms (change of address, direct credit advice and more) and the ability to verify shareholding details.

## RECENT QBE DIVIDENDS

DATE PAID	TYPE	RECORD DATE	CENTS PER SHARE	FRANKING %
26 March 1999	interim	5 March 1999	8.5	50
1 October 1999	final	10 September 1999	18.5	50
31 March 2000	interim	10 March 2000	14.0	10
29 September 2000	final	11 September 2000	15.0	35
12 April 2001	final	26 March 2001	16.0	30
28 September 2001	interim	7 September 2001	16.5	25
12 April 2002	final	25 March 2002	13.5	15
3 October 2002	interim	13 September 2002	16.5	12
11 April 2003	final	19 March 2003	18.5	12
25 September 2003	interim	1 September 2003	20.0	15
25 March 2004	final	9 March 2004	22.0	30
20 September 2004	interim	30 August 2004	24.0	50
23 March 2005	final	7 March 2005	30.0	50
16 September 2005	interim	29 August 2005	33.0	50
29 March 2006	final	10 March 2006	38.0	50
14 September 2006	interim	1 September 2006	40.0	60

## TOP TWENTY SHAREHOLDERS AS AT 31 JANUARY 2007

NAME OF REGISTERED SHAREHOLDER	NUMBER OF SHARES	% OF TOTAL
J P Morgan Nominees Australia Limited	167,496,594	20.46
Westpac Custodian Nominees Limited	137,909,712	16.84
National Nominees Limited	125,831,645	15.37
ANZ Nominees Limited	64,891,683	7.93
Citicorp Nominees Pty Limited	53,794,762	6.57
HSBC Custody Nominees (Australia) Limited	38,515,676	4.70
Cogent Nominees Pty Limited	19,664,694	2.40
Queensland Investment Corporation (c/- National Nominees Limited)	16,881,244	2.06
AMP Life Limited	8,552,295	1.04
Westpac Financial Services Limited	8,021,488	0.98
UBS Nominees Pty Ltd	6,492,626	0.79
RBC Dexia Investor Services Australia Nominees Pty Limited	6,266,944	0.77
Suncorp Custodian Services Pty Limited	4,081,766	0.50
QBE Management Services Pty Limited	2,789,180	0.34
Perpetual Trustee Company Limited	2,751,522	0.34
Australian Reward Investment Alliance (c/- J P Morgan Nominees Australia Limited)	2,702,614	0.33
UBS Wealth Management Australia Nominees Pty Ltd	2,603,516	0.32
Australian Foundation Investment Company Limited	2,459,487	0.30
Victorian WorkCover Authority (c/- National Nominees Limited)	2,256,268	0.28
IAG Nominees Pty Limited	1,815,969	0.22
<b>Total</b>	<b>675,779,685</b>	<b>82.54</b>

# QBE SUBSTANTIAL SHAREHOLDERS AS AT 31 JANUARY 2007

NAME	NUMBER OF SHARES	% OF TOTAL <sup>(1)</sup>	DATE OF NOTICE
UBS Nominees Pty Ltd and its related bodies corporate	64,790,756	8.06	9 June 2006
AXA Asia Pacific Holdings Limited	60,527,694	7.53	6 October 2006
The Capital Group Companies Inc	48,268,558	5.90	25 January 2007
Barclays Global Investors Australia Limited	38,779,454	5.04	25 July 2005

(1) % of total at date of notice.

## DISTRIBUTION OF SHAREHOLDERS AND SHAREHOLDINGS AS AT 31 JANUARY 2007

SIZE OF HOLDING	NUMBER OF SHAREHOLDERS	%	NUMBER OF SHARES	%
1 – 1,000	27,538	53.39	14,194,742	1.73
1,001 – 5,000	19,927	38.63	43,725,818	5.34
5,001 – 10,000	2,421	4.69	17,096,005	2.09
10,001 – 100,000	1,512	2.93	36,086,550	4.41
100,001 or more	184	0.36	707,602,455	86.43
<b>Total</b>	<b>51,582</b>	<b>100.00</b>	<b>818,705,570</b>	<b>100.00</b>

## SHAREHOLDINGS OF LESS THAN A MARKETABLE PARCEL AS AT 31 JANUARY 2007

	SHAREHOLDERS		SHARES	
	NUMBER	% OF TOTAL	NUMBER	% OF TOTAL
Holdings of 17 or less shares	393	0.76	3,244	0.00

## FINANCIAL CALENDAR

2007

23 February	Profit and dividend announcement for the year ended 31 December 2006 Annual report available on website.
2 March	Annual report posted to shareholders with notice of AGM and proxy form.
7 March	Shares begin trading ex-dividend.
14 March	Record date for determining shareholders' entitlement to 2006 final dividend.
2 April	2006 final dividend paid.
4 April	Annual General Meeting
30 June	Half year end
20 August*	Profit and dividend announcement for the half year ending 30 June 2007.
4 September*	Shares begin trading ex-dividend.
10 September*	Record date for determining shareholders' entitlement to 2007 interim dividend.
26 September*	2007 interim dividend paid.
31 December	Year end

\* Dates to be confirmed.

## QBE ANNOUNCEMENTS TO THE ASX

2007

Announced the acquisition of a strategic holding in Austbrokers.	9 February
Announced the reinstatement of the dividend reinvestment plans.	9 February
Announced the acquisition of Seguros Cumbre SA de CV.	2 February
Announced the acquisition of Winterthur US Holdings, Inc.	5 January

2006

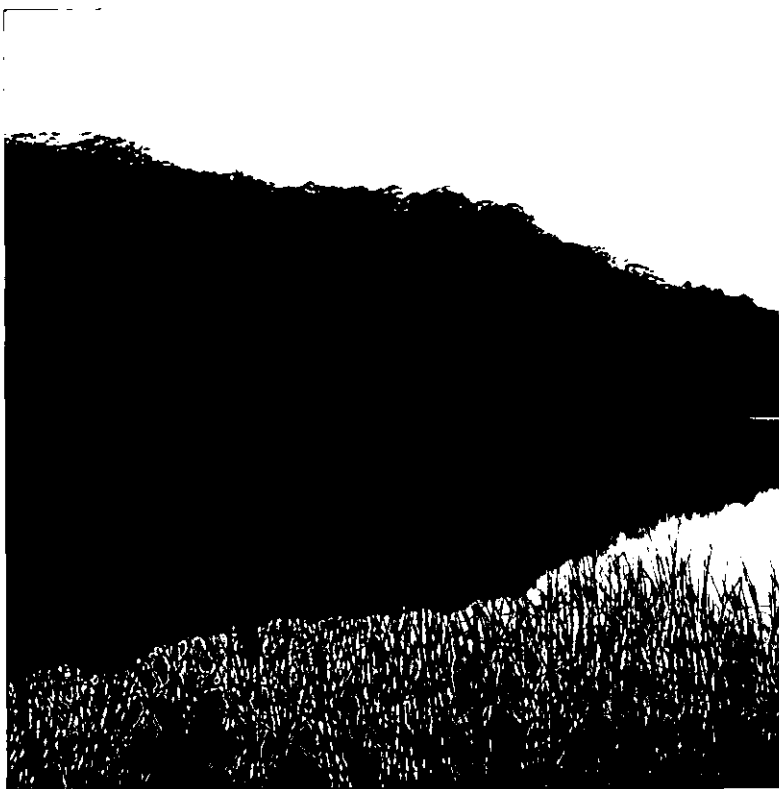
Announced the acquisition of Praetorian Financial Group in the US and 2006 results update.	13 December
Announced the appointment of Duncan Boyle to QBE's board of directors.	28 September
Announced the suspension of QBE's Dividend Reinvestment Plan ("DRP") and Dividend Election Plan ("DEP") due to the company's strong capital position.	16 August
Announced record half year profit and interim dividend.	16 August
Announced private institutional placement of non-cumulative perpetual preferred securities.	12 July
Announced new closing date for DRP election forms.	6 June
Announced further exercise of options on achievement of performance hurdles in respect of a 2004 acquisition. Subsequent exercise announced on 10 October.	1 June
Announced further conversion of QBE LYONS securities into ordinary shares of the company. Subsequent conversions announced on 22 May and 22 December.	21 April
2006 AGM	7 April
Announced DRP pricing details.	3 March
Announced a record 2005 profit and increased dividend.	23 February



The 2006 QBE Group annual report features photographs by a multi award winning Australian photographer, Peter Lik. The images in the annual report represent a selection of landscape works from Australia and around the world. Peter was born in Melbourne and now spends much of his life travelling the world capturing the striking scenic images for which he has become renowned.



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